

ORDER NO. 1926

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;  
Robert G. Taub, Vice Chairman; and  
Mark Acton

Rate Adjustment Due to Extraordinary  
or Exceptional Circumstances

Docket No. R2013-11

ORDER GRANTING EXIGENT PRICE INCREASE



Washington, DC 20268-0001

December 24, 2013

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(Issued December 24, 2013)

I. EXECUTIVE SUMMARY

This Order reviews the Postal Service's second request for rate increases to offset losses suffered as a result of the Great Recession of 2008 – 2009. Its first request, in 2010, was denied as the Commission found that although the Great Recession was an extraordinary and exceptional event, the Postal Service had failed to quantify losses as due to that recession.

The Postal Service now requests a 4.3 percent increase designed to add \$1.8 billion a year to its bottom line. In support of this request, the Postal Service presents an analysis to quantify the volumes it lost due to the Great Recession. This analysis assumes that negative volume trends that began during the Great Recession identify continuing volume losses caused by the Great Recession.

The Postal Service contends that in FY 2012 alone it lost 53.5 billion pieces, worth \$6.6 billion in net revenue, as a result of the Great Recession. It further claims that it is continuing to suffer annual Great Recession-related losses. It suggests that by the end of FY 2014, the net revenue lost as a result of the Great Recession will approach \$40 billion.

There is substantial mailer opposition to the Postal Service proposal. Mailer presentations conclude that the Postal Service overestimates volume losses due to the Great Recession. They demonstrate that these losses are mostly the predictable result of electronic diversion. They oppose adding the exigent rate increase to base rates.

The Commission finds the Postal Service's econometric analysis has several flaws. First, the variables used in the model do not separate the effects of economic activity from electronic diversion. Second, the model is incomplete with respect to its choice of macroeconomic variables. Third, the analysis conflates the effects of the Great Recession with other factors. Fourth, the Postal Service relies on unsupported assumptions to attribute volume loss to the Great Recession.

The Commission corrected these flaws by considering both the positive and negative impacts of the Great Recession on mail volume and tying the impact on mail volumes by class to the period of negative economic factors. The Commission considers mail volume loss as due to the Great Recession only until: (1) a sufficient number of relevant macroeconomic indicators demonstrate a return to positive trends; (2) the rate of change for Postal Service mail volumes is positive; (3) the Postal Service regains its ability to project mail volumes; and (4) the Postal Service demonstrates an ability to adjust operations to the lower volumes.

The Commission estimates a total of 25.3 billion pieces were lost between 2008 and 2011 as a result of the Great Recession. This volume loss equates to \$2.8 billion in 2014 after-rates contribution (profit).

The Commission analyzes the Postal Service request to recover lost contribution through rate adjustments in light of the statutory requirements. It finds that the Postal Service's dangerously low liquidity levels make the rate adjustments necessary to maintain and continue needed service. The proposed rate adjustments are reasonable and within the Commission's estimate of total loss. The proposed rate adjustments are equitable in that they are distributed proportionately to all categories of mail. For those reasons, the Postal Service may implement the proposed rates as scheduled.

However, allowing the rates to remain in effect indefinitely would result in over recovery of the financial impact of the Great Recession on the Postal Service. The rates proposed by the Postal Service will enable it to recover the lost contribution in less than two years.

The Commission finds the Postal Service proposal to collect this rate adjustment indefinitely inconsistent with the fundamental policies underlying the price cap. Under the price cap, the Postal Service is expected to respond to declining volumes by reducing costs and improving efficiencies. Although the Great Recession accelerated volume decline, it does not eliminate the Postal Service's obligation to respond to revenue losses by reducing costs or improving efficiency. Consequently, the Commission must determine an appropriate end date for collection of the exigent rate adjustment.

The Commission directs the Postal Service to report quarterly on the revenues generated by these rates, and to develop a plan to phase out these rates once they have produced the revenues justified by this request.

## II. PROCEDURAL HISTORY

### A. The First Exigent Request

As part of the comprehensive changes enacted by the Postal Accountability and Enhancement Act, Pub. L. No. 109-435, 120 Stat. 3198 (2006) (PAEA), Congress has authorized the Postal Service to adjust rates on an expedited basis for market dominant products “due to either extraordinary or exceptional circumstances.” 39 U.S.C. § 3622(d)(1)(E).

The Commission adopted rules that established procedures to permit review of exigent rate adjustments<sup>1</sup> within a functional and flexible framework on an expedited basis.<sup>2</sup> The rules were designed to foster efficient preparation and filing of an exigent rate case and reflect the statutory requirement that determinations on proposed exigent rate adjustments be made within 90 days of the date of filing. The rules require the Postal Service to submit supplemental information in support of its proposal for an exigent rate adjustment to demonstrate that the request comports with the statutory requirements of 39 U.S.C. § 3622(d)(1)(E). In this docket the Commission considers, for the second time, a request by the Postal Service for an exigent rate adjustment.

On July 6, 2010, the Postal Service filed an exigent request, pursuant to 39 U.S.C. § 3622(d)(1)(E) and 39 C.F.R. § 3010.60 *et seq.*, seeking to increase rates for market dominant products by 5.6 percent, on average.<sup>3</sup> After holding a public hearing during which three Postal Service witnesses testified and after reviewing the

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<sup>1</sup> The term “exigent” is commonly used in referring to rate adjustments made under section 3622(d)(1)(E) and to the circumstances that permit such adjustments. It is used in this Order for convenience as a shorthand reference to the statutory term “extraordinary and exceptional.” See Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustment, September 30, 2010, at 13, n.12 (Order No. 547), (discussion of the term “exigent” and its origins).

<sup>2</sup> Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007, at 65-73 (Order No. 43).

<sup>3</sup> Docket No. R2010-4, Exigent Request of the United States Postal Service, July 6, 2010 (First Exigent Request).



comments and reply comments of numerous commenters, the Commission issued an order on September 30, 2010 denying the exigent request.<sup>4</sup> The Commission found that although the Great Recession and its impact on postal volumes constituted an “extraordinary or exceptional circumstance,” the Postal Service failed to show that the proposed rate adjustments were “due to” that circumstance, rather than a general need for revenue.<sup>5</sup> *Id.* at 50, 64. The Commission determined that the proposed rate adjustments were “not designed to respond to the recent recession, or its impact on mail volume.” *Id.* at 3. Specifically, the Commission found that the Postal Service failed to “quantify the impact of the recession on postal finances, address how the requested rate increases relate to the recession’s impact on postal volumes, or identify how the requested rates resolve the crisis at hand.” *Id.* at 4.

On October 22, 2010, the Postal Service filed a petition before the United States Court of Appeals for the District of Columbia Circuit, appealing the Commission’s order denying its requested rate adjustments. On May 24, 2011, the court issued its opinion in *United States Postal Service v. Postal Regulatory Commission*, 640 F.3d 1263 (D.C. Cir. 2011), denying in part and granting in part the Postal Service’s petition for review. The court affirmed the Commission’s determination that the plain meaning of the phrase “due to” in section 3622(d)(1)(E) mandates that there be a causal relationship between the amount of the proposed rate adjustment and the impact of the extraordinary or exceptional circumstance on the Postal Service’s finances. 640 F.3d at 1264. However, the court concluded that there is no plain meaning of “due to” with respect to the closeness of the causal connection between the proposed adjustments

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<sup>4</sup> Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustments, September 30, 2010 (Order No. 547).

<sup>5</sup> In Order No. 547, the circumstance that the Commission found to be extraordinary or exceptional was “the recent recession and its impact on postal volumes.” *Id.* at 50. Many commentators now refer to that recession as the “Great Recession.” See, e.g., Henry S. Farber, *Job Loss in the Great Recession: Historical Perspective from the Displaced Workers Survey, 1984-2010* (Nat’l Bureau of Econ. Research, Working Paper No. 17040, May 2011), available at <http://www.nber.org/papers/w17040>. In this order, the Commission uses the term “Great Recession” to mean “the recent recession” described in Order No. 547.

and the lost revenue. *Id.* at 1268. The court remanded the issue to the Commission to "fill the statutory gap by determining how closely the amount of the adjustments must match the amount of the revenue loss. . . ." *Id.*

The court issued its mandate on July 11, 2011. That same day, the Commission initiated proceedings on remand, providing interested persons with the opportunity to comment on the proper interpretation of the phrase "due to" as the standard of causation in 39 U.S.C. § 3622(d)(1)(E).<sup>6</sup> On September 20, 2011, the Commission issued Order No. 864, its order on remand.<sup>7</sup> With respect to the causal nexus between the proposed exigent rate adjustments "due to" extraordinary or exceptional circumstances, the Commission concluded that the Postal Service must show that the proposed rate adjustments are causally linked to – but do not exceed – the "net adverse financial impact" of the circumstances giving rise to the claim. Order No. 864 at 45 (emphasis omitted). The Commission stated that the Postal Service is not required to quantify the net adverse financial impact "with absolute precision." *Id.* at 48. However, it indicated that the Postal Service must justify its exigent requests with "supportable methods commensurate with the amount of the proposed adjustment." *Id.* at 49.

#### B. The Current Request

On September 26, 2013, the Postal Service filed the instant request, pursuant to 39 U.S.C. § 3622(d)(1)(E) and 39 C.F.R. § 3010.60 *et seq.* of the Commission's rules.<sup>8</sup> The Request seeks to adjust rates for market dominant products above the limitations provided by 39 U.S.C. § 3622(d)(1)(A) and 39 C.F.R. § 3010.11. Request at 1. The proposed exigent rates represent an average increase of approximately 4.3 percent. *Id.*

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<sup>6</sup> Docket No. R2010-4R, Notice and Order Establishing Procedures on Remand, July 11, 2011 (Order No. 757).

<sup>7</sup> Docket No. R2010-4R, Order Resolving Issues on Remand, September 20, 2011 (Order No. 864).

<sup>8</sup> Renewed Exigent Request of the United States Postal Service in Response to Commission Order No. 1059, September 26, 2013 (Request).

at 2. If approved, the exigent rates will be implemented on January 26, 2014. *Id.* Supporting justification for the proposed exigent rate adjustment is provided in the statement of Altaf Taufique, a pricing economist for the Postal Service, in the further statement of Thomas E. Thress, an economic consultant, and in the statement of Stephen J. Nickerson, the finance manager for the Postal Service.<sup>9</sup>

1. Description of the Request

In support of its filing, the Postal Service asserts that the Request is “due to” “extraordinary or exceptional circumstances,” is “reasonable and equitable,” and is “necessary to enable the Postal Service, under best practices of honest, efficient and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” Request at 9, 13, 35.

*Extraordinary or Exceptional Circumstances.* Regarding the circumstances giving rise to the Request, the Postal Service indicates that it accepts the Commission’s finding that the Great Recession and its impact on postal volumes constitute circumstances that authorize an exigent rate adjustment. *Id.* at 9. Because the Commission previously concluded (in Order No. 547) that the Great Recession was an extraordinary or exceptional circumstance for purposes of section 3622(d)(1)(E), the Postal Service sees no “need for a detailed discussion regarding the recession.” *Id.* at 12.

The Postal Service states that it has proposed exigent rate adjustments “in order to recover a portion of the contribution that it lost due to the recession.” *Id.* at 9. Through its witnesses, it estimates that volume losses attributable to the Great

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<sup>9</sup> Statement of Altaf Taufique on Behalf of the United States Postal Service, September 26, 2013 (Taufique Statement); Further Statement of Thomas E. Thress on Behalf of the United States Postal Service, September 26, 2013 (Thress Statement); Statement of Stephen J. Nickerson on Behalf of the United States Postal Service, September 26, 2013.

Recession translate to contribution losses of \$6.644 billion in FY 2012.<sup>10</sup> It estimates that in total, the Great Recession caused it to lose \$22.110 billion from 2008 through 2012, and that its losses will continue to grow in the foreseeable future.<sup>11</sup> The Postal Service estimates that if the exigent rate adjustments are approved, it will recover \$1.78 billion in annual contribution. Request at 10. Because the amount of contribution it expects to recover as a result of the exigent rate adjustments is only a portion of the amount of contribution it estimates it has lost due to the Great Recession, the Postal Services concludes that the exigent request satisfies the “due to” clause of section 3622(d)(1)(E). *Id.* at 16.

*Necessary.* The Postal Service asserts that because its present and forecasted liquidity position is dangerously low, the proposed exigent rate adjustments are necessary for it to continue to provide adequate postal services. *Id.* at 13. However, the Postal Service states that even if the Request is approved, it will continue to incur large net losses each year. *Id.* at 15. It indicates that it hopes that the exigent rate adjustment will provide it with sufficient liquidity to continue operations into 2017. *Id.* at 14-15. The Postal Service asserts that it “could have permissibly asked for a larger” adjustment. *Id.* at 17. It also indicates that, if the adjustments are approved, it does not expect to rescind the exigent rate adjustments “until such time as Congress enacts comprehensive reform legislation.” *Id.*

*Honest, Efficient, and Economical Management.* With respect to the “honest, efficient, and economical management” standard, the Postal Service highlights various initiatives it has undertaken in an effort to decrease costs and increase revenue. Specifically, the Postal Service points to ongoing efforts to decrease workhours, increase productivity, streamline its mail processing network, consolidate delivery points, reduce retail hours, and reduce labor costs. *Id.* at 22-31. The Postal Service

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<sup>10</sup> United States Postal Service Notice of Further Revisions to the Statement of Stephen Nickerson – Errata, November 22, 2013, at 3 (Nickerson Statement).

<sup>11</sup> See Reply Comments of the United States Postal Service, December 6, 2013, at 15.

expects to save \$7.8 billion by 2016 as a result of these initiatives. *Id.* at 34. The Postal Service indicates that it hopes to continue to increase revenues from its competitive products. It also points to efforts to introduce market dominant products and promotions to engage customers and attract additional volume and revenue. *Id.* at 31-33.

*Reasonable and Equitable.* The Postal Service, relying on Taufique's testimony, states that the proposed exigent rate adjustments are reasonable. *Id.* at 35. Taufique contends that because the proposed exigent rate adjustments will increase annual contribution by approximately \$1.78 billion and because the Postal Service's estimated FY 2012 loss of contribution due to the Great Recession is \$6.6 billion, the proposed adjustments are "moderate and reasonable." Taufique Statement at 10.

The Postal Service also relies on Taufique's testimony in support of its conclusion that the proposed exigent rate adjustments are equitable. Request at 35. The proposed exigent rate adjustments increase rates by 4.3 percent on average. Taufique explains that the burden of the 4.3 percent increase is "spread equally to all classes of mail and, as much as practicable, to all products and even to each rate cell," subject to a few exceptions. Taufique Statement at 11. The Postal Service contends that it is "inherently equitable" to seek recovery of lost contribution "broadly and uniformly, rather than targeting particular classes or products." Request at 35.

*Harmonizing the Exigent Request with Market Dominant Rate Adjustments.* The Postal Service explains how it wishes to harmonize the proposed exigent rate adjustments with the inflation-based rate adjustments that the Commission has approved since issuing Order No. 547 on September 30, 2010. Since that date, the Commission has approved inflation-based rate adjustments in six separate

proceedings.<sup>12</sup> As a result, the Postal Service estimates that it currently has unused rate adjustment authority in the following amounts:<sup>13</sup>

**Table II-1**  
**Unused Rate Adjustment Authority**

<b>CLASS</b>	<b>UNUSED AUTHORITY<sup>14</sup></b>
First-Class Mail	- 0.466 %
Standard Mail	- 0.354 %
Periodicals	- 0.524 %
Package Services	- 0.312 %
Special Services	+ 1.814 %

The Postal Service proposes two methods for harmonizing its exigent request with its prior inflation-based rate adjustments. The Postal Service's preferred approach would reflect a state of affairs as if the Commission had not denied the First Exigent Request. According to this approach, all unused rate adjustment authority that arose prior to June 2010 would be considered exhausted, "while price adjustments resulting from inflation after that date are simply normal Type 1 adjustments requiring no special

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<sup>12</sup> Docket No. R2011-2, Order Revising Postal Service Market Dominant Price Adjustments, February 16, 2011 (Order No. 675); Docket No. R2012-3, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 22, 2011 (Order No. 987); Docket No. 2013-1, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 16, 2012 (Order No. 1541); Docket No. R2013-1, Order on Standard Mail Rate Adjustments and Related Mail Classification Changes, December 11, 2012 (Order No. 1573); Docket No. R2013-7, Order Granting Market Dominant Price Adjustment for Insurance, June 21, 2013 (Order No. 1756); Docket No. R2013-10, Order on Price Adjustments for Market Dominant Products and Related Classification Changes, November 21, 2013 (Order No. 1890).

<sup>13</sup> Notice of Revisions to Exigent Request of the United States Postal Service – Errata, October 18, 2013 (Revised Request) at 37.

<sup>14</sup> The negative unused rate authority for four classes of mail is the result of a period of deflation in the 12-month average change in CPI-U that occurred between the rate increases filed in dockets R2009-2 and R2011-2. For a complete explanation as to how this negative authority was created, see Docket No. R2011-1, Order Approving Market Dominant Classification and Price Changes, and Applying Price Cap Rules, December 10, 2010, at 6-11 (Order No. 606).

accounting.” Request at 36. The Postal Service indicates that a second “workable” approach would be to treat all current unused rate adjustment authority as “eliminated.” *Id.* at 37.

## 2. The Proceedings on the Request

On September 30, 2013, the Commission issued an order providing public notice of the Postal Service’s request, establishing a docket for consideration of the request, establishing an expedited procedural schedule, and appointing a representative to represent the interests of the general public in this proceeding.<sup>15</sup> The expedited procedural schedule provided for three technical conferences, a public hearing, and deadlines for filing initial comments and reply comments. Order No. 1847, Attachment. On September 30, 2013, pursuant to 39 U.S.C. § 504(a), the Chairman designated herself to serve as the Presiding Officer in these proceedings.<sup>16</sup> On October 17, 2013, the Presiding Officer issued an order revising the procedural schedule due to the suspension in Commission activities associated with a lapse in appropriations.<sup>17</sup>

To clarify the Postal Service’s Exigent Request, the Presiding Officer issued, and the Postal Service responded to, 12 information requests. These submissions are identified in Appendix B. Technical conferences for witnesses Taufique, Thress, and Nickerson were held on October 24, October 31, and November 1, 2013, respectively. A public hearing was held on November 19 and 20, during which the Commission questioned the Postal Service’s three witnesses. Interested persons participated in the hearing by submitting questions for the Commission to ask the witnesses. Proposed questions were submitted by the Greeting Card Association (GCA), Pitney Bowes, the Public Representative, and MPA on behalf of itself and eleven additional interested

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<sup>15</sup> Notice and Order Concerning Exigent Request, September 30, 2013 (Order No. 1847).

<sup>16</sup> Notice of the Chairman Designating Presiding Officer, September 30, 2013.

<sup>17</sup> Ruling Adjusting Procedural Schedule, October 17, 2013.

persons (or groups).<sup>18</sup> Following the hearing, the Commission received 17 comments and 11 reply comments from interested persons. These submissions are identified in Appendix A.

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<sup>18</sup> Public Hearing Questions Submitted by the Greeting Card Association, November 8, 2013; Questions Proposed by Pitney Bowes Inc. for Hearing on November 19, 2013 (Witness Taufique), November 8, 2013; Questions Proposed by the Public Representative for the November 18-20, 2013, Public Hearing, November 8, 2013; Questions Proposed by MPA – the Association of Magazine Media, The American Catalog Mailers Association, Inc., Direct Marketing Association, Inc., Alliance of Nonprofit Mailers, Association of Marketing Service Providers, Major Mailers Association, National Newspaper Association, Printing Industries of America, Quad/Graphics, Inc., R.R. Donnelley, Software & Information Industry Association/American Business Media, and Time Inc. for Hearing on November 19, 2013, November 8, 2013.



### III. STATUTORY REQUIREMENTS FOR EXIGENT RATE ADJUSTMENTS

#### A. Interpretation of the Exigent Rate Provision

Exigent rate adjustments are authorized by 39 U.S.C. § 3622(d)(1)(E). The relevant portions of section 3622 provide:

**(d) Requirements.—**

**(1) In general.**—The system for regulating rates and classes for market-dominant products shall—

**(E)** notwithstanding any limitation set under subparagraphs (A) and (C), and provided there is not sufficient unused rate authority under paragraph (2)(C), establish procedures whereby rates may be adjusted on an expedited basis due to either extraordinary or exceptional circumstances, provided that the Commission determines, after notice and opportunity for a public hearing and comment, and within 90 days after any request by the Postal Service, that such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

On October 29, 2007, the Commission adopted regulations governing the filing of requests for authority to make rate adjustments pursuant to section 3622(d)(1)(E).<sup>19</sup>

#### 1. Order No. 547

In Order No. 547, the Commission began its discussion of the Postal Service's First Exigent Request by reviewing the role of exigent rate cases in the modern system of rate regulation adopted by the Postal Accountability and Enhancement Act, Pub. L. No. 109-435, 120 Stat. 3198 (2006) (PAEA). Order No. 547 at 5-24. That discussion included review of the primary purposes and development of the PAEA; the improved

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<sup>19</sup> See Docket No. RM2007-1, Order No. 43. The regulations governing exigent rate adjustments are codified in 39 C.F.R. part 3010, subpart E. 39 C.F.R. § 3010.60, *et seq.*

rate adjustment process established by the PAEA; the legislative development of section 3622(d)(1)(E); and the method used by the Commission to interpret section 3622(d)(1)(E).

*Primary purposes and development of the PAEA.* In section II. A. of Order No. 547, the Commission identified five principles incorporated into the PAEA in an effort to reform the Postal Service: (1) implement best practices of management; (2) enhance transparency; (3) provide for greater operating flexibility; (4) foster greater accountability; and (5) ensure self-financing. Order No. 547 at 6-7. The Commission noted that the PAEA gave the Postal Service new pricing flexibility. *Id.* It also noted that this new pricing flexibility was balanced by increased regulatory oversight to ensure transparency and accountability. *Id.*

*The PAEA's Improved Rate Adjustment Process.* In section II. B. of Order No. 547, the Commission briefly summarized the relevant history of postal rate regulation under the Postal Reorganization Act, Pub. L. No. 91-375, 84 Stat. 719 (1970) (PRA). *Id.* at 7-10. That summary noted that by 2006, the PRA's cost-of-service ratemaking process was widely viewed as unnecessarily time consuming, expensive, and litigious. *Id.* at 8. In addition, there was major concern that the PRA's ratemaking process lacked incentives for the Postal Service to operate efficiently or control costs. *Id.* at 9.

Section II.B.1. described the new paradigm established by the PAEA for regulating rates and classes for market dominant products. *Id.* at 10-13. The existing system for establishing market dominant rates was completely revamped by removing any reference to cost-of-service regulation and by establishing a price cap regime as the regulatory model that streamlined the process for establishing market dominant rates. *Id.* at 10.<sup>20</sup>

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<sup>20</sup> The term "price cap" refers to the inflation-based annual limitation on the percentage change in rates described at 39 U.S.C. § 3622(d)(1)(A).

The price cap also provided the Postal Service with incentives to control costs and sought to incentivize the Postal Service to operate in a more business-like manner. *Id.* at 11. Although the new price cap system permitted the Postal Service to respond more quickly to market conditions, it could not, without regulatory approval, recover losses by increasing rates above the price cap. *Id.* at 11-12.

While ratepayers were given far less input in the rate-setting process, the rates they paid would be subject to the price cap, and therefore more predictable and stable. *Id.* at 12. The price cap was the single most important safeguard for mailers. *Id.* at 13. Elsewhere in Order No. 547, the Commission described the price cap as the “centerpiece of the modern system of ratemaking that the Commission has established under the PAEA.” *Id.* at 38. Except under very limited circumstances, rates could not exceed the price cap. *Id.* at 13.

In section II.B.2 of Order No. 547, the Commission explained that although the price cap was to play a central role in the new regulatory regime, Congress also recognized that there may be a need to permit the cap to be pierced to respond to emergency situations. *Id.* at 13-14. It was to provide for such situations that Congress enacted a safety valve rate provision. That safety valve is codified in 39 U.S.C. § 3622(d)(1)(E), the provision quoted above and commonly referred to as the “exigent rate provision.” While the exigent rate provision could play an important role in emergency situations, “all parties, including the Postal Service, acknowledged that proposed rate increases could only exceed the price cap under very limited circumstances.” Order No. 547 at 13. Otherwise, resort to the exigent rate provision

“...would defeat the purpose of a price cap and, in raising rates beyond those defined by the cap, contribute to even greater volume decline, leading to a vicious spiral of destructive rate increases.”

*Id.* at 14 (quoting a statement by former Postmaster General John Potter).

*Legislative development of section 3622(d)(1)(E).* In section II.C. of Order No. 547, the Commission analyzed the purpose and legislative history of section 3622(d)(1)(E). *Id.* at 14-24. The Commission traced the 11-year legislative development of section 3622(d)(1)(E) from the 104th Congress through the enactment of the PAEA at the end of the 109th Congress. *Id.* The Commission found that section 3622(d)(1)(E) evolved from a less restrictive to a more stringent standard. *Id.* at 20. The Commission concluded that section 3622(d)(1)(E) is more restrictive, as a whole, than its predecessor provisions in prior bills "because it combines independent requirements proposed separately by the House and Senate" during the 109th Congress. *Id.* These requirements include a finding of "either extraordinary or exceptional circumstances" and an adjustment that is "reasonable and equitable and necessary...." See 39 U.S.C. § 3622(d)(1)(E).

*Method of interpreting section 3622(d)(1)(E).* After reviewing the background to the exigent rate provision, the Commission briefly discussed judicial precedents that it intended to follow in interpreting that provision. Order No. 547 at 24-26. Under those precedents, the interpretation of section 3622(d)(1)(E) began with the language of the statute itself. Given the absence of statutory definitions, reliance was placed upon the plain meaning of the words used by Congress to express its intent. Consideration was given to the structure and purposes of the statute in order to provide context in interpreting statutory terms. Section 3622(d)(1)(E) was interpreted as part of a coherent and symmetrical statutory scheme in which it was part of a harmonious whole. The Commission also took into consideration relevant legislative history. *Id.*

*Commission analysis and conclusions.* In Order No. 547, the Commission denied the Postal Service's proposed exigent rate adjustments. Based upon its interpretation of section 3622(d)(1)(E), the Commission concluded that the recent recession constituted an "extraordinary or exceptional circumstance". *Id.* at 38-53. However, the Commission concluded that the Postal Service had failed to demonstrate the necessary causal connection between the "extraordinary or exceptional

circumstance” and the rate adjustments that the Postal Service proposed to implement. *Id.* at 53-68.

## 2. Judicial Review of Order No. 547

In reviewing Order No. 547, the Court in *United States Postal Service v. Postal Regulatory Commission*, 640 F.3d 1263 (D.C. Cir. 2011) upheld the Commission’s conclusion that the plain meaning of the term “due to” in section 3622(d)(1)(E) “mandates a causal relationship between the amount of a requested adjustment and the exigent circumstances’ impact on the Postal Service.” 640 F.3d at 1267. The Court went on, however, to rule that the same “due to” term had “no similar plain meaning regarding the closeness of the causal connection.” *Id.* at 1268. The Court, therefore, remanded to the Commission to perform the so-called *Chevron* step 2 analysis in order to resolve the ambiguity inherent in the term “due to” when applied to determine “how closely the amount of the adjustments must match the amount of the revenue lost as a result of the exigent circumstances.”<sup>21</sup> *Id.*

## 3. Order No. 864

In its order on remand, the Commission noted that the Court had not faulted the Commission’s use of the traditional method of statutory interpretation, only its failure to go beyond the plain meaning of “due to” to perform the *Chevron* step 2 analysis. Order No. 864 at 31. Following the interpretive method that it had followed in Order No. 547, the Commission proceeded to summarize the key findings upon which it had previously relied. It reviewed the purposes and policies of the PAEA (*id.* at 32-33); the role of the exigent rate provision in the statutory scheme (*id.* at 34-37); and the legislative history of

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<sup>21</sup> The *Chevron* step 2 analysis is the second of two steps of analysis used in the interpretation of statutes. Step 1 involves a determination of whether Congress has spoken unambiguously to the precise question at issue. If so, effect must be given to Congress’ intent as so expressed. The step 2 analysis is required if the statute is either silent or ambiguous with respect to a specific issue. An agency’s step 2 analysis must be upheld by a reviewing court if it is based upon a permissible construction of the statute. *Chevron U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

the exigency provision (*id.* at 37-39). The Commission then proceeded to follow the Court's guidance in performing the *Chevron* step 2 analysis. *Id.* at 32-44. The Commission concluded "that exigent rate adjustments are permitted only if, and to the extent that, they compensate for the net adverse financial impact of the exigent circumstances." *Id.* at 45.

The Commission also provided general guidance regarding the proof required to demonstrate the causal nexus of "due to":

*Quantification Requirement.* Establishment of a "due to" causal nexus requires the Postal Service to "quantify the net financial impact of the exigent circumstances." *Id.* at 46. This financial impact sets the upper bound of any exigent rate adjustment. *Id.* at 47. Quantification of the net adverse financial impact requires the Postal Service to "factor out the financial impact of non-exigent circumstances." *Id.* at 48. The Postal Service is not, however, required to quantify this impact with absolute precision. *Id.* Nevertheless, some circumstances will lend themselves to more accurate quantification than others." *Id.*

*Nature and Amount of Proof.* The evidence needed to support quantification of the net adverse financial impact of "extraordinary or exceptional" circumstances "will vary in degree depending on the nature of the exigent circumstances, the amount of the proposed adjustment, and the complexity of the exigent request." *Id.* at 49.

*Supportable Quantification Methods.* The Postal Service's quantification of the net adverse financial impact "must be justified through supportable methods commensurate with the amount of the proposed adjustment." *Id.* "A larger amount requires more rigorous estimation techniques." *Id.* at 50.

*Adjustment Limited to Net Adverse Financial Impact.* The Postal Service cannot seek an exigent rate adjustment that exceeds "the net adverse financial impact of the exigent circumstances" on which the adjustment is based. *Id.* at 50-51.

The Commission concluded by noting its obligation “to apply its interpretation of the causal nexus of ‘due to’ by granting or denying the Exigent Request if the Postal Service wishes to pursue it.” *Id.* at 53. The Commission therefore prescribed procedures for enabling the Postal Service to pursue its exigent rate adjustment request. *Id.* at 53-55.

#### 4. The Postal Service’s Current Request and Commenters’ Opposition

The Postal Service did not renew its request for an exigent rate adjustment until September 26, 2013. Commenters cite this delay in arguing that the requested rate adjustment should be barred as untimely. American Bankers Association (ABA) Comments at 6-7; NPPC et al. Comments at 26-30. Others allege that the Postal Service is in fact attempting to use its liquidity crisis and the failure of Congress to enact legislation as the circumstances warranting a rate adjustment and that neither of these circumstances constitutes an “extraordinary or exceptional” circumstance. *E.g.*, Valpak Comments at 17-25. Certain commenters challenge the factual basis for the Postal Service’s claim that its proposed rate adjustments are “due to” an “extraordinary or exceptional” circumstance. *E.g.*, MPA et al. Comments at 6-48. Still other commenters take issue with the Postal Service’s assertions that its proposed rate adjustments are reasonable and equitable and necessary. *E.g.*, NPPC et al. Comments at 31-40. Some of these latter commenters challenge the Postal Service’s claims that it has followed “best practices of honest, efficient, and economical management.” *E.g.*, Valpak Comments at 89-99. Assuming an exigent rate adjustment were authorized, several commenters oppose what they characterize as an open-ended adjustment. *E.g.*, ABA Comments at 7. There are also issues regarding harmonization of exigent rate adjustments with the price cap (*e.g.*, PR Comments at 36) and a suggestion that an adjustment of the relative shares of contribution from market dominant products and competitive products should be considered as a means of addressing the Postal Service losses (UPS Comments at 12).

## 5. The Commission's Interpretation of Key Statutory Elements

Resolution of the foregoing issues depends upon the proper interpretation of key elements of section 3622(d)(1)(E). Those key elements are: (1) the provision that rates may be adjusted on an "expedited basis"; (2) the requirement that an exigent rate adjustment request be based upon an "extraordinary or exceptional" circumstance; (3) the requirement that requested rate adjustments be "due to" the "extraordinary or exceptional" circumstance; and (4) the requirement that requested rate adjustments be "reasonable and equitable and necessary to enable the Postal Service under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States."

The Commission's interpretation of these key elements will be based upon the findings that it previously made in Order Nos. 547 and 864 regarding the purposes and policies of the PAEA (e.g., Order No. 547 at 6, 12, 38, and 64; and Order No. 864 at 32-33); the role of the exigency provision in the statutory scheme (Order No. 547 at 5-14; and Order No. 864 at 34-37); and the legislative history of the exigency provision (Order No. 547 at 14-24; and Order No. 864 at 37-39).

The Commission will also follow the traditional methods of statutory interpretation previously identified in Order No. 547 at 24-27 and Order No. 864 at 30-39. When warranted, interpretations will be based upon the plain meaning of the words of the statute as the *Chevron* step 1 analysis requires. Those key terms considered to be ambiguous will be interpreted in accordance with the *Chevron* step 2 analysis.

### *The Provision Authorizing Rates to be Adjusted on an "Expedited Basis."*

The ABA and the National Postal Policy Council (NPPC) argue that the Postal Service's Request is untimely under the provision in section 3622(d)(1)(E) that states that "rates may be adjusted on an expedited basis." ABA Comments at 7. In a related argument, NPPC contends that the equitable doctrine of laches bars a request for



exigent rate adjustments based on losses that occurred after September, 2010. NPPC et al. Comments at 26-30. Valpak supports the NPPC claim. Valpak Reply Comments at 16.

The Postal Service anticipates ABA's statutory argument by asserting in its Request that the statute does not provide a deadline for filing exigent rate requests. Request at 39. The Postal Service does, however, concede that there might be circumstances in which the passage of time could prevent it from meeting other requirements in section 3622(d)(1)(E), such as the requirement that a proposed exigent rate adjustment be "necessary." *Id.* at 40-41. In response to NPPC's assertion of the doctrine of laches, the Postal Service argues that because of its governmental status it is not subject to the doctrine of laches. Postal Service Reply Comments at 119-123.

On its face, section 3622(d)(1)(E) does not provide a deadline for the filing of exigent rate adjustment requests. Nevertheless, as the Postal Service acknowledges, circumstances could arise in which a delay in filing an exigent rate request could preclude compliance with other requirements in section 3622(d)(1)(E), such as the requirement that exigent rate adjustments be "necessary." Since the statute is silent on this point, the Commission will address this issue in its *Chevron* step 2 analysis of the "necessary" requirement in Chapter V.

The doctrine of laches invoked by NPPC is an equitable doctrine that depends for its application upon the review of specific facts. Given that it relates to the question of timeliness, it will be considered in connection with ABA's timeliness argument in Chapter V.

*The "Extraordinary or Exceptional" Circumstances Requirement.*

In Order No. 547, the Commission stated that "[i]n evaluating whether the 'extraordinary or exceptional circumstances' requirement has been met, it is not the type of circumstance that is dispositive, but its departure from the commonplace—whether it rises to the level of 'extraordinary or exceptional.'" Order No. 547 at 53. On the basis of

that interpretation of “extraordinary or exceptional circumstances,” the Commission concluded “that the recent recession and its impact on postal volumes is an ‘extraordinary or exceptional’ circumstance.” *Id.* at 50.

In the remand proceeding, the Commission, in response to arguments made by GCA and the Postal Service, reaffirmed its finding that the 2008-2009 recession and its impact on postal volumes constituted “extraordinary or exceptional” circumstances. Order No. 864 at 29.

While none of the commenters in the current proceeding challenges the Commission’s interpretation of the term “extraordinary or exceptional circumstances,” a number of commenters argue that the Postal Service is, in fact, basing its proposed rate adjustment request on its liquidity problem and the pendency of postal reform legislation, neither of which qualify as an “extraordinary or exceptional circumstance.” *E.g.*, Valpak Initial Comments at 17-25. This argument is based upon an interpretation of the Postal Service’s Request, and not the statute. The Postal Service Request identifies a financial harm “due to” an extraordinary or exceptional circumstance, specifically, the 2008-2009 recession and its impact on postal volumes. As discussed in Chapter IV, the Commission finds the Postal Service has failed to justify its proposal, but that it has suffered financial harm due to the Great Recession that it may recover through an exigent rate adjustment..

*The “Due To” Requirement.*

The “due to” requirement in section 3622(d)(1)(E) has previously been interpreted to require a causal connection between a requested rate adjustment and the impact of an “extraordinary or exceptional” circumstance on the Postal Service. *E.g.*, Order No. 547 at 54. It has also been interpreted to limit an exigent rate adjustment to compensation for the net adverse financial impact of the “extraordinary or exceptional” circumstance. Order No. 864 at 45. The Commission has rejected an interpretation

that would extend application of the causal nexus to individual classes of mail. *Id.* at 47, n.34.

*The “Reasonable and Equitable and Necessary” Clause.*

Assuming the Postal Service bases an exigent rate adjustment request on bona fide “extraordinary or exceptional circumstances” and demonstrates that its proposed adjustment is “due to” those circumstances, it must, in the words of section 3622(d)(1)(E), establish that:

“...such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.”

The shorthand reference used to refer to this portion of section 3622(d)(1)(E) is the “reasonable and equitable and necessary” clause. In fact, this clause contains five key elements, each of which requires interpretation by the Commission. Those five key elements are the words “reasonable”, “equitable”, and “necessary” and the phrases “best practices of honest, efficient, and economical management” and “postal services of the kind and quality adapted to the needs of the United States.”

None of these words or phrases is defined in the statute. Following the method of statutory interpretation used in Order No. 547 and Order No. 864, the Commission’s first step is to look to the plain meaning of the words used to determine if those five key elements “speak clearly and unambiguously for themselves.” 640 F.3d at 1268 (quoting *Adams v. Director, OWCP*, 886 F.2d 818, 821 (6<sup>th</sup> Cir.1989) as cited by *Kimber v. Thiokol Corp.*, 196 F.3d 1092, 1100 (10<sup>th</sup> Cir. 1999)). If they do, the Commission may then use their plain meaning to determine whether, on the facts presented, the Postal Service has satisfied the requirements for an exigent rate adjustment. If one or more of these key elements do not “speak clearly and unambiguously for themselves, the

Commission must perform the *Chevron* step 2 analysis before applying them to the facts and issues presented in this proceeding.

For the reasons set forth below, the Commission concludes that all five of the key elements contained in the “reasonable and equitable and necessary” clause are ambiguous and that a *Chevron* step 2 analysis is required.

Only one commenter, Pitney Bowes, attempts to demonstrate that the words “reasonable” and “equitable” and “necessary” can all be interpreted using the plain meaning rule. Pitney Bowes Comments at 6. Using the Merriam Webster dictionary, Pitney Bowes asserts that the appropriate meaning of the word “reasonable” is “fair and sensible” and that the word “equitable” means “just and fair.” *Id.* at 6. Noting that the concept of “fairness” (for which it does not proffer a definition) is common to both “reasonable” and “equitable”, Pitney Bowes seeks to use the term “fairness” to link “reasonable” and “equitable” under the PAEA to the concept of “fairness” under the Postal Reorganization Act (PRA). On the basis of this asserted link, Pitney Bowes argues that the “extensive regulatory history” of the term “fairness” under the PRA should be used in implementing the PAEA’s exigent rate provision. *Id.*

There are several problems with Pitney Bowes’ approach. First, it equates the meaning of both “reasonable” and “equitable” in the exigent rate provision. This implicitly suggests that “reasonable” and “equitable” are duplicative thereby rendering one or the other of these terms potentially unnecessary.<sup>22</sup> This result contradicts one of the basic principles of statutory construction, namely, that statutes should, if possible, be interpreted in a way that gives a purpose and operative effect to each word. Order No. 547 at 25 (citing *Russello v. United States*, 464 U.S. 16, 23 (1983); *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997); *Food and Drug Administration v. Brown &*

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<sup>22</sup> Nor are the overlapping definitions of “reasonable” and “equitable” offered by Pitney Bowes unique to the source it cited for the plain meaning of those words. For example, Webster’s *Encyclopedic Unabridged Dictionary* (G. & C. Merriam Co. 1989) defines “reasonable” to mean “equitable, fair, just” and defines “equitable” to mean “just and right; fair; reasonable.”

*Williamson Tobacco Corporation*, 529 U.S. 120, 132-33 (2000); and *Dole Food Co. v. Patrickson*, 538 U.S. 468, 477(2003)). Second, Pitney Bowes has failed to provide any support for the conclusion that Congress intended the terms “reasonable” or “equitable” in the PAEA’s exigent rate provision to mean the same thing as “fairness” under the PRA’s cost-of-service ratemaking regime.

Similar problems are presented by Pitney Bowes’ attempt to assign a plain meaning to the word “necessary.” Using the same Merriam Webster Dictionary, it asserts that “necessary” means “absolutely needed”. Pitney Bowes Comments at 6. Whatever may be the merit of this plain meaning definition standing alone, the term “necessary” must, as Pitney Bowes itself points out, be interpreted in the context of “best practices of honest, efficient, and economical management” and “postal services of the kind and quality adapted to the needs of the United States.” However, neither of those qualifying phrases “speaks clearly and unambiguously.” The phrase “best practices of honest, efficient, and economical management” is not self-defining. “Best practices” can vary from industry-to-industry and over time. The concept of “honest, efficient, and economical management” can also vary from context-to-context and over time. Similarly, “postal services of the kind and quality adapted to the needs of the United States” is an ever-evolving concept, as the Commission discussed in its Report to Congress and the President on the Postal Service’s universal service obligation.<sup>23</sup> Thus, even if the word “necessary” were, by itself, considered to be clear and unambiguous, its connection to the concepts of “best practices” and “postal needs” introduces elements of uncertainty and ambiguity regarding its meaning that preclude the use of a plain meaning definition.

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<sup>23</sup> Report on Universal Postal Service and the Postal Monopoly, December 19, 2008 at 15-84 (USO Report).

In early 2007, the Commission conducted a rulemaking proceeding to implement the then-newly enacted PAEA.<sup>24</sup> Included among the regulations adopted by the Commission in that proceeding were the regulations that now govern exigent rate cases. Because of the uncertainties inherent in any exigent rate proceeding, the Commission intentionally refrained from premature rulings on issues that might arise in circumstances that no one would be able to predict:

The Commission intends its subpart E provisions to establish a functional and flexible framework for Type 3 [exigent] cases. The assumption is that the approach will accommodate associated uncertainties, such as what events might give rise to a filing and how much additional revenue the Postal Service might seek. In particular, the proposal reflects a decision to forgo attempting to identify with specificity circumstances on either side of the question of qualifying circumstances. Thus, the proposal not only excluded definitions of “triggering events” for Type 3 filings, but also excluded defining, in advance, circumstances that would not qualify. This decision, which reflected consideration of earlier comments, is the focus of suggested revisions in this round.

Order No. 43 at 65.

In concluding its discussion of its new exigent rate regulations, the Commission provided the following response to those commenters who had requested it “to address specific aspects related to interpretation and administration of 39 U.S.C. § 3622(d)(1)(E).” Order No. 43 at 72-73:

The Commission acknowledges the interest some commenters express in resolution of several issues related to interpretation and administration of the PAEA’s provision for an exigent increases [sic], including adoption of definitive interpretations of rescission, application of increases, and impact on unused rate adjustment authority and the attributable cost floor. It declines at this time to adopt to [sic]

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<sup>24</sup> Docket No. RM2007-1, Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking, January 30, 2007 (Order No. 2).

either policy statements or specific regulations on these points. The state of the record on these issues, as the Postal Service points out, makes such actions premature.

*Id.*

To obtain the information needed to apply the statutory requirements of the “reasonable, equitable, and necessary” clause for exigent requests in circumstances that could not possibly be anticipated at the time the regulations were adopted, the Commission expressly required the Postal Service to submit, among other things:

(4) A full discussion of why the requested increases are necessary to enable the Postal Service, under best practices of honest, efficient and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States;

(5) A full discussion of why the requested increases are reasonable and equitable as among types of users of market dominant products;

39 C.F.R. §§ 3010.61(a)(4) and (5).

These filing requirements tracked the language of the statute for good reason. Given the inability of anyone to predict what types of “extraordinary or exceptional” circumstances might arise and the nature and extent of their impacts, the Commission left it to the Postal Service in the first instance to assess what was “reasonable;” what was “equitable;” and what was “necessary” under “best practices” to maintain and continue the Nation’s requisite “postal needs.” After giving the Postal Service the first opportunity to apply the statutory standards in the specific context presented, the Commission (and participants seeking additional information through the Commission) could develop the record further through information requests to the Postal Service based upon its (or their) interpretation and application of the statutory requirements to the circumstances presented. See Order No. 43 at 69-70; and 39 C.F.R. § 3010.62.

Ultimately, what is “reasonable,” what is “equitable,” and what is “necessary,” what are “best practices,” and what are appropriate “postal needs” under the exigent

rate provision are inherently imprecise and ambiguous. What is reasonable in one context could be unreasonable in another. What is “equitable” under one set of circumstances, could be obviously inequitable under another. What is necessary in one setting could be unnecessary in a different setting.

In order to make the ultimate determinations regarding reasonableness, equitableness, necessity, best practices, and appropriate postal needs on the facts presented in this case the Commission undertakes a *Chevron* step 2 analysis to interpret the key terms in the “reasonable and equitable and necessary” clause.

*The “reasonable and equitable and necessary” clause is subordinate to the “due to” clause.*

The price cap is the centerpiece of the PAEA’s regulatory paradigm. The exigent rate provision in section 3622(d)(1)(E) is a narrow exception to the price cap. To be permitted, exigent rate adjustments must be “due to” “extraordinary or exceptional” circumstances. If the proposed adjustments fail to meet the “due to” test, they are prohibited even if they might otherwise be considered “reasonable and equitable and necessary.” In other words, the “reasonable and equitable and necessary” clause is subordinate to the “due to” clause and can only be applied to justify rate adjustments that have first been shown to be “due to” “extraordinary or exceptional” circumstances.

*The “Reasonable” and “equitable” and “necessary” requirements serve different roles.*

As previously noted, all words of a statute must, if possible, be interpreted to have purpose and effect. The words “reasonable,” “equitable,” and “necessary,” are imprecise. Each could be interpreted to include considerations that are possible under one of the others. This has previously been demonstrated, *supra*, by comparison of definitions contained in widely used dictionaries. Common usage also demonstrates the potential for overlap. For example, if “reasonable” were the only standard that appeared in the statute, it could cover considerations of equity and necessity. Thus, an



argument could be made that for a proposal to be “reasonable,” it must also be “equitable” and “necessary.” If it were inequitable or unnecessary it would not be “reasonable.” Similar arguments could be made regarding the standards of “equitable” and “necessary.” To avoid such duplication, the Commission adopts an interpretation that the “reasonable,” “equitable,” and “necessary” requirements of section 3622(d)(1)(E) serve different roles in assessing the propriety of a proposed exigent rate adjustment.

*The “reasonable and equitable” requirements need be considered only if the “necessary” requirement has been satisfied.*

A potential rate adjustment that is “due to” “extraordinary or exceptional” circumstances must also be “necessary.” The proper interpretation of the word “necessary” requires recognition of the context in which it appears. Before determining whether a proposed rate adjustment is “necessary,” the Commission must first determine that the adjustment is “due to” “extraordinary or exceptional” circumstances. The same considerations that require a narrow interpretation of the “due to” clause (Order No. 547 at 53-57 and Order No. 864 at 30-42) apply to the interpretation of the “necessary” requirement. Important goals of the PAEA are to foster the efficiency of Postal Service’s operations and to promote rate predictability and stability. See, e.g., Order No. 547 at 11. The exigent rate provision is also recognized to be a limited “safety valve” exception to the price cap. *United States Postal Service v. Postal Regulatory Commission*, 640 F.3d at 1264 (D.C. Cir. 2011).

Further evidence that the “necessary” requirement is to be interpreted in a manner consistent with the central role of the price cap and the narrow scope of exigent exceptions to that cap can be found in the “best practices” and “postal needs” standards in the succeeding phrases that provide additional content to the “necessary” requirement.

An interpretation that the rate adjustment be “necessary” is an important prerequisite to an exigent rate adjustment that is consistent with the objectives of price cap regulation even as it provides an exception to the price cap. The “necessary” requirement provides a limitation on amounts demonstrated by the Postal Service to be “due to” “extraordinary or exceptional” circumstances. The “necessary” clause establishes a test that goes beyond the “due to” requirement. A proposed rate adjustment that meets the “due to” requirement must also be “necessary.”

Finally, the Commission concludes that unless the Postal Service makes a showing that satisfies a rigorous test of “necessary,” there is no point in assessing whether the proposed adjustments are “reasonable” and “equitable.” The Commission cannot approve as otherwise “reasonable” and “equitable” proposed exigent rate adjustments that are not “necessary.”

*The “best practices of honest, efficient, and economical management” standard is primarily a forward looking concept that allows consideration of past management practices relevant to the issue of whether rate adjustments are “necessary.”*

In the context in which it appears in section 3622(d)(1)(E) the “best practices” standard applies in determining whether a proposed rate will enable the Postal Service to “maintain and continue the development of postal services....” The words “maintain and continue” imply considerations regarding the present and the future. To “maintain” postal services involves consideration of what is presently being done by the Postal Service. To “continue” the development of postal services involves consideration of what the Postal Service will do during some future period. The linking of “best practices” in order “to enable” the Postal Service to maintain and continue the development of postal services strongly suggests that the “best practices” standard should be interpreted and applied as a forward looking concept. Such interpretation is further supported by the purpose to be served by following best practices, namely, “to enable” present (maintain) and future (continue) efforts by the Postal Service to provide needed postal services.

Several commenters implicitly endorse a backward-looking interpretation in their discussion of the “best practices” standard. See SIIA/ABM Comments at 2-3; Valpak Comments at 92-99. A backward-looking application of the “best practices” standard is essentially a means of assessing whether the Postal Service’s failure to manage its operations properly is the real source of the Postal Service’s request for an exigent rate adjustment. If the Postal Service has followed sub-par management practices, it may be possible to demonstrate that absent such practices the requested exigent rate adjustment would not be necessary. Instead, it might be suggested that improved management practices, not exigent rate adjustments, would be the appropriate response. On the other hand, the adverse impact of “extraordinary or exceptional” circumstances might be great enough to satisfy the “necessary” requirement, notwithstanding even potentially serious management shortcomings. Given the possibility that Postal Service management practices prior to the occurrence of the extraordinary or exceptional circumstance might be responsible for the requested rate adjustments, the “best practices” standard cannot be interpreted as exclusively forward looking.

Application of the “best practices” standard as a backward-looking concept raises the question of how far back Postal Service management practices should be reviewed. The further back in time a best practices review extends, the more speculative it may become. Just how far back a best practices review should be made depends upon the facts and circumstances presented in a particular case. In general, the Commission would expect Postal Service actions that occur in the aftermath of an extraordinary or exceptional circumstance would be a fair subject for review. Proponents of a backward-looking review that considers management practices pre-dating the occurrence of the extraordinary or exceptional circumstance would have to demonstrate the appropriateness of such a review.

*The forward-looking review of management practices operates as a potential limit on the “necessity” of exigent rate adjustments.*

The phrase “best practices of honest, efficient, and economical management” appears directly after, and modifies, the statute’s requirement that exigent rate adjustments be “necessary to enable the Postal Service” to provide postal services. The Commission interprets this phrase as imposing a potential limit on the amount of an exigent rate adjustment that can be found to be necessary. Thus, in deciding whether to approve an exigent rate adjustment, the Commission may approve only adjustments that, by means of best management practices, are “necessary” for the Postal Service to maintain and continue the development of appropriate postal services. As such, the “best practices” standard operates as a potential further limit on the exigent rate adjustments. Namely, the Commission may approve only adjustments that are necessary when using best management practices.

The “best practices” standard allows the Commission to deny or limit an exigent rate adjustment if it concludes that the adjustment, or some portion of the adjustment, is unnecessary if best management practices are not, as they should be, followed. The possible denial, or reduction, of proposed exigent rate adjustments operates in a manner similar to the price cap by incentivizing efficient operations of the Postal Service. In that regard, the “best practices” standard furthers the overall purposes of the PAEA even when it is necessary to pierce the price cap.

*The “best practices standard” is an evolving standard which requires context-specific assessment that must include consideration of the unique circumstances under which the Postal Service operates.*

The meaning of the phrase “best practices of honest, efficient, and economical management” is imprecise and therefore ambiguous. The same can be said of its constituent elements—“best practices”, “honest”, “efficient”, and “economical.” Nor does the legislative history of the PAEA offer definitive guidance regarding the particular meaning to be given to these words. As discussed in Order No. 547, the language “best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the

needs of the United States” first appeared in H.R. 22 (1999) introduced in the 106<sup>th</sup> Congress and was included in subsequent House bills until ultimately included in the exigent rate provision of the PAEA. Order No. 547 at 16-18. Congressional reports discussing the predecessor bills did not provide an explanation or discussion of the meaning to be attributed to the language used in the statute. See 109<sup>th</sup> Cong., H. Rep. 109-66, Postal Accountability and Enhancement Act, April 28, 2005, at 47-48.

Language similar to that contained in the “reasonable and equitable and necessary” clause of the exigent rate provision appears in 39 U.S.C. § 404(b). That section empowers the Postal Service to establish classes of mail and rates for postal services:

Except as otherwise provided, the Governors are authorized to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees for postal services in accordance with the provisions of chapter 36. Postal rates and fees shall be reasonable and equitable and sufficient to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue to the development of postal services of the kind and quality adapted to the needs of the United States. [emphasis added]

Putting aside the fact that this section and the exigent rate provision have different purposes,<sup>25</sup> this section is of limited utility in interpreting section 3622(d)(1)(E). Section 404(b) lacks definitions of the same key terms as section 3622(d)(1)(E) and has no useful legislative history shedding light on their proper interpretation.<sup>26</sup>

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<sup>25</sup> Section 404(b) authorizes the Postal Service to exercise certain corporate powers. By contrast, section 3622(d)(1)(E) is a regulatory provision intended to ensure that legal standards and the congressional intent they embody are properly administered.

<sup>26</sup> A further important difference can be found in the fact that the term “necessary” does not appear in section 404(b). From this it can be inferred that there are stricter limits on the amounts that can be recovered by means of an exigent rate adjustment under section 3622(d)(1)(E) than can generally be sought by the Governors.

The ambiguity inherent in these terms is due in part to the imprecision of the terms themselves. Concepts of “best practices,” “efficient,” and “economical” are all ambiguous on their face. Although the meaning of “honest” might appear to be self-evident, it, too, could be ambiguous because it depends upon assumptions regarding appropriate standards of conduct. For example, if, in a business context, certain conditions are generally assumed to be risks, the failure of one party expressly to identify such risks could not fairly be considered dishonest. Situations like this are routinely comprehended by the legal concept of *caveat emptor*—“let the buyer beware.” The ambiguity inherent in all these terms is compounded by the fact that all are in a state of continuing evolution. “Best practices” last year may, because of intervening developments or changes in opinion, no longer be “best practices” this year.

For these reasons, the Commission expects the Postal Service and commenters to provide, either expressly or implicitly, their understanding of what constitutes “best practices,” and “honest, efficient, and economical management” in their respective discussions of the “best practices” standard.

While normative standards may change, a proper interpretation of the “best practices” standard requires that consideration be given to the parameters under which the Postal Service operates. These parameters include legal obligations, such as the universal service obligation, the 6-day delivery requirement, binding contractual obligations such as labor agreements, and such other limitations upon, or prerogatives enjoyed by, the Postal Service.

The Commission undertakes a fact-specific analysis of the element “best practices of honest, efficient, and economical management” in Chapter V.

*The “postal needs” standard is dependent upon the circumstances in which the exigent request is filed.*

The “necessary” requirement of section 3622(d)(1)(E) requires consideration of whether the proposed adjustment is needed to enable the Postal Service to maintain

and continue “postal services of the kind and quality adapted to the needs of the United States.” Neither the PAEA nor its legislative history explains what postal needs are to be used as the appropriate standard against which to assess an exigent rate adjustment request. Moreover, postal needs change over time for the same, or similar, reasons that the Postal Service’s universal service obligation changes. See, e.g., USO Report at 15-84. The Commission concludes that the content of this standard depends upon the circumstances in which particular exigent rate requests are filed.

The Commission analyzes the “postal needs” standard in light of the circumstances of this Request in Chapter V.

*The “reasonable” requirement assesses whether an exigent rate adjustment that is “due to” either “exceptional or extraordinary circumstances” and “necessary” is appropriate.*

For reasons discussed above, the Commission has concluded that consideration of the “reasonable” requirement should be preceded by resolution of the “due to” requirement and the “necessary” requirements. Only exigent rate requests that are “due to” “extraordinary or exceptional” circumstances and meet the “necessary” requirement are capable of meeting the “reasonable” requirement. The scope of the “reasonable” requirement is further qualified by the inclusion of the separate and distinct “equitable” requirement, discussed below. For both requirements to have meaning, considerations of reasonableness and equity must be considered separately.

The “reasonable” requirement presents the issue of whether it is “reasonable” for the Postal Service to recover the entire amount, or some lesser amount, of a requested rate adjustment that is determined by the Commission to have met both the “due to” and “necessary” requirements. The “reasonable” requirement does not permit recovery of amounts larger than the amounts determined to be “due to” an “extraordinary or exceptional” circumstances and “necessary.”

Because of the ambiguity inherent in the word “reasonable,” it must be interpreted flexibly to permit consideration of relevant issues (apart from those contemplated by the “equitable” requirement) as the factual context of specific cases require. There are nevertheless certain considerations that the Commission anticipates are likely to be presented in exigent rate cases and, if they are, that should be considered under the statute’s “reasonableness” requirement. These considerations relate to the overall rates requested and the total contribution of those rates. They include considerations of whether the total amounts requested are appropriate; whether the proposed increases will create “rate shock” for affected mailers; and whether mail elasticities might adversely affect the potential exigent rate recovery by reducing demand more than expected. Also properly included in determinations under the “reasonable” requirement are the objectives and factors of section 3622.

The Commission undertakes an analysis of the “reasonableness” requirement in Chapter VI.

*The “equitable” requirement considers the relationship between and among individual rates.*

Based upon the principle of statutory interpretation discussed in previous sections, the requirement that exigent rate adjustments must be “equitable” is a separate and distinct requirement that differs from the “reasonable” and “necessary” requirements. Like the “reasonable” requirement, consideration of whether a proposed adjustment is “equitable” is required only after the Commission has determined that a proposed rate adjustment is “due to” an “extraordinary or exceptional” circumstance; only after the Commission has determined the proposed adjustment to be “necessary”; and only after the Commission has determined the proposed adjustment to be “reasonable”.

The Commission interprets the requirement that exigent rate adjustments be “equitable” to require consideration of all relevant circumstances regarding the



relationship between and among individual rates. Section 3622 provides, among other things, objectives and factors that the Commission must balance when considering whether an exigent rate adjustment is equitable. See 39 U.S.C. §§ 3622(b) and (c). These sometimes competing objectives and factors include, for example, rate stability, assuring adequate revenues to maintain financial stability, Postal Service pricing flexibility, the need for each class or type of mail service to cover its attributable costs and make a contribution to institutional costs, the effect of rate increases upon the general public and business mail users, the value of mail service actually provided each class or type of service to both the sender and recipient, available alternative means for sending and receiving letters and other mail matter at reasonable costs, the educational, cultural, scientific, and informational value of mail to the recipient.

As with the other requirements of section 3622(d)(1)(E), the facts and circumstances of each specific request will provide needed context for determining equity as guided by consideration of relevant objectives and factors of section 3622. The Commission considers these facts and circumstances as they relate to the “equitable” requirement in Chapter VI.

#### B. Roadmap to the Commission's Analysis

The Commission's analysis of the Postal Service's Request is organized as follows:

Chapter IV will analyze the impact of the Great Recession on the Postal Service and determine whether the Postal Service's Request complies with the “due to” requirement.

Chapter V will determine whether the Postal Service's Request meets the requirement that its proposed exigent adjustment is necessary to enable it under best practices of honest, efficient, and economical management to maintain and continue the development of postal services adapted to the needs of the United States.

Chapter VI will determine whether the proposed exigent adjustment satisfies the requirements that it be reasonable and equitable.

Chapter VII will determine whether the request for an open-ended collection period is appropriate.

Chapter VIII will analyze and resolve all residual issues.

#### IV. THE IMPACT OF THE GREAT RECESSION ON THE POSTAL SERVICE

This chapter addresses the Postal Service's Request as it relates to the "due to" requirement of 39 U.S.C. § 3622(d)(1)(E). Based on the Commission's decisions in Docket No. R2010-4, the Postal Service argues that it is entitled to recover for contribution lost due to the Great Recession, and attempts to quantify that amount. First, this chapter addresses preliminary matters dealing with arguments that the Postal Service's Request is not truly due to the Great Recession, but rather due to other circumstances that do not qualify as extraordinary or exceptional. Second, this chapter reviews the Postal Service's analysis quantifying the impact of the Great Recession on Postal Service volumes. Third, this chapter summarizes commenters' arguments in response to the Postal Service presentation. Finally, this chapter evaluates the Postal Service's and commenters' arguments and makes findings as to the impact of the Great Recession on Postal Service mail volumes. As part of this analysis, the Commission converts its calculation of this impact on mail volumes into a lost contribution amount that the Postal Service is eligible to recover through above Consumer Price Index (CPI) rate increases.

##### A. Preliminary Matters

Several commenters argue that the Postal Service's request is not actually due to the Great Recession, but rather due to other circumstances. The commenters argue that the Postal Service should not be allowed to recover under section 3622(d)(1)(E) because these other circumstances are not extraordinary or exceptional. These comments fall into two primary groups: (1) those that categorize the Postal Service's request as due to its liquidity crisis; and (2) those that categorize the Postal Service's request as due to Congressional inaction.

1. Request “due to” Liquidity Crisis

*Initial comments.* The Public Representative suggests that the Postal Service’s exigent request reflects a “cost of service” price increase, rather than an exigent increase. PR Comments at 9. The Public Representative argues that although the Postal Service says its price increases are due to the recession, it wants the additional funds to alleviate its liquidity problem. *Id.* at 10. In reviewing the Postal Service’s recent Form 10-Q and most recent 5-year plans, the Public Representative concludes that the Postal Service has repeatedly stated that its liquidity problem is due to a decline in mail volume caused primarily by electronic diversion. *Id.* at 10-12.

NPPC is also concerned that the Postal Service’s liquidity problems are a primary consideration in the exigency filing. NPPC, et al. Comments at 4. NPPC asserts that a lack of liquidity is not an “extraordinary or exceptional circumstance” because “Congress did not intend the exigency provision to be a general cure to the Postal Service’s financial problems.” *Id.*

Valpak argues that the Board of Governors’ decision to seek an exigent increase was improperly premised on the Postal Service’s liquidity crisis. Valpak Comments at 17-18. Valpak asserts that the Postal Service conflates the “necessary” and “due to” requirements of section 3622(d)(1)(E) and improperly seeks to use its liquidity situation to justify its exigent request. *Id.* at 18-19. Valpak contends that Commission precedent from Docket No. R2010-4 expressly forecloses the Postal Service’s liquidity problems from being the basis of an exigent request. *Id.* at 19-20. Valpak categorizes the Postal Service’s request as an “attempt to return to pre-PAEA cost-of-service ratemaking” by seeking to obtain additional money from mailers to solve its liquidity problems. *Id.* at 20. Valpak blames the Postal Service’s liquidity problems on its failure to address losses from underwater products. *Id.* at 67-69. In particular, Valpak states that there is nothing “extraordinary, exceptional – or even unusual – about a shortfall in liquidity after consciously, knowingly, and deliberately continuing to lose money on underwater products year after year.” *Id.* at 69.

Valassis contends that the Postal Service incorrectly views the concept of necessity as “entirely unmoored from the asserted exigent circumstance” in this proceeding. Valassis Comments at 11. Valassis believes the Request improperly focuses on the liquidity crisis and long-term structural and governance problems. *Id.* at 27.

*Reply Comments.* GCA supports the Public Representative’s assessment that the Postal Service’s Request is based on its need for funds rather than the recession. GCA Reply Comments at 24. GCA argues that the Postal Service’s recent Form 10-Q and 5-year plan are intended to be comprehensive documents, and they attribute the Postal Service’s liquidity problems to Retiree Health Benefits Funding and electronic diversion—not the recession. *Id.* Valpak also supports the assessments of Public Representative and NPPC, which assert that the Request is “due to” the Postal Service’s liquidity crisis. Valpak Reply Comments at 11.

In his Reply Comments, the Public Representative reiterates that the Postal Service’s liquidity and cash flow issues should not be considered exigent events. PR Reply Comments at 5. He asserts that the recession may have been a contributing factor to the Postal Service’s cash flow and liquidity issues, but it is a minor factor when compared with the Retiree Health Benefits Fund funding issues and electronic diversion. *Id.* The Public Representative concludes that the Postal Service’s Request is improperly justified and is filed to slightly improve “business as usual” cash flow and liquidity issues. *Id.* at 7.

In its Reply Comments, the Postal Service contests the comments of the Public Representative, Valpak, and Valassis. Postal Service Reply Comments at 70. The Postal Service explains that its liquidity discussion is directed at the requirement that its Request be necessary to enable it, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States. *Id.* The Postal Service asserts that the Commission’s rules reflect a distinction between the “due to”

requirement and the “necessary” requirement, as do previous Commission orders. *Id.* at 71. The Postal Service argues that “[t]he plain language of the ‘necessary’ clause makes considerations of the Postal Service’s overall liquidity situation relevant to an exigent request,” as adequate liquidity is key to its ability to maintain and continue postal services. *Id.* at 71-72.

The Postal Service explains that statements from the Governors concerning the Postal Service’s liquidity reflect the Governors’ determination that the increase is “necessary” rather than a determination that the Postal Service’s liquidity is the exceptional or extraordinary circumstance. *Id.* at 86. The Postal Service argues that statements by Valpak and Valassis to the contrary make “no logical sense because it would demand that the Governors make the important decision about piercing the cap in a vacuum.” *Id.* at 87.

## 2. Request “due to” Congressional Inaction

*Initial Comments.* SMC asserts that the Postal Service’s filing is not “due to” the “Great Recession,” but rather, “due to” the inability or unwillingness of Congress to agree and act.” SMC, et al. Comments at 5.<sup>27</sup> SMC states that the exigency request was filed because Congress has not passed comprehensive postal reform and asserts

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<sup>27</sup> Several other commenters offer varying views on the role Congressional reform should take in this proceeding. See FSR & NAMIC Comments at 2, 12 (urging the Commission to deny the request until the adjournment of the 113<sup>th</sup> Congress because Commission action may be perceived by Congress “as a permanent fix to the USPS’s fiscal issues”); SIIA & ABM Comments at 3 (acknowledging Congress continues to debate reform which would put the Postal Service on more sound financial footing than the exigent rate increase); ABA Comments at 8 (noting that many of the Postal Service’s primary cost drivers must be addressed by Congress); Valassis Comments at 35 (asserting that the Request “extinguished what little resolution Congress had to complete postal reform this year”). The Postal Service contests the assertions of these commenters. Postal Service Reply Comments at 87-89.

In Docket No. R2010-4(R), the Commission denied the Postal Service’s request to stay the prior exigent proceeding while legislation was pending. Docket No. R2010-4(R), Order Denying Motion to Stay and Establishing Further Procedures, October 31, 2011, at 8 (Order No. 937). Citing to several cases, the Commission was persuaded by the fact courts have generally declined to stay proceedings because “the legislative process is uncertain, and the results of pending legislation are highly speculative.” *Id.* at 7-8. The same analysis applies to these comments. As the Commission concluded in Order No. 937, “[i]f, and when, any legislation is enacted, its effects can be addressed.” *Id.* at 8.

that structural problems, including lack of control over healthcare costs, the required pre-funding of retiree health care, and the system for funding obligations for pension costs, are the problems that led the Postal Service to seek the increase. *Id.* at 4-5. SMC cites the statements of several Postal Service officials and Postal Service press releases to support the theory that the Postal Service filed the Request for reasons other than the recession. *Id.* at 5.

Valpak asserts that in addition to the liquidity crisis, the Postal Service's pursuit of postal reform is the reason for the Postal Service's Request. Valpak Comments at 21. Citing to multiple references from the Request, witness statements, and Postal Service statements and press releases, *id.* at 22-24, Valpak asserts that "the Postal Service filing was designed to force Congress' hand to enact the legislation the Postal Service desires." *Id.* at 24. Valpak argues that the Commission should deny the Postal Service's request because it is an attempt to pressure Congress to enact reform. *Id.* at 25.

*Reply comments.* In its Reply Comments, the Postal Service argues that Valpak's characterization of the Request as an attempt to pressure Congress is baseless. Postal Service Reply Comments at 89. The Postal Service asserts that its references to Congressional action are important to explanations required by 39 U.S.C. § 3622(d)(1)(E) and the Commission's regulations. *Id.* at 90. The Postal Service also asserts that comments by Postal Service officials identifying the need for reform outside these proceedings are both appropriate and irrelevant. *Id.* The Postal Service states that "it is no secret that the Postal Service has been seeking postal reform for years and it is entirely proper that the Governors considered the uncertain prospect of new legislation in making the decision to file" its Request. *Id.* at 90-91.

NPMHU supports the Postal Service's position that the Request was made "due to" the Great Recession. NPMHU Reply Comments at 2. NPMHU explains that if the Postal Service did not have liquidity problems or if Congress had acted, the Postal

Service may not have filed the Request, but that does not establish that the Request is not “due to” the recession. *Id.*

In its Reply Comments, Valpak reiterates its view by supporting SMC's comments arguing that one of the principal drivers behind the Postal Service's Request is the desire for postal reform legislation. Valpak Reply Comments at 11.

### 3. Commission Analysis

In Order No. 547, the Commission found the Great Recession to be an extraordinary or exceptional circumstance. Order No. 547 at 49-53. In Order No. 864, the Commission described the showing the Postal Service must make to demonstrate the financial harm caused by the Great Recession. Order No. 864 at 45-53. Its Request attempts to do so first by quantifying the volumes lost “due to” the Great Recession and second by monetizing those volumes in terms of lost contribution. See, e.g., Request at 2; Thress Statement at 7-10; Nickerson Statement at 3-5. The comments arguing that the Postal Service's Request is “due to” its inadequate liquidity levels or Congressional inaction mischaracterize the Postal Service's Request.

In addition to demonstrating that the Request is “due to” an exceptional or extraordinary circumstance, section 3622(d)(1)(E) requires that the Postal Service make several additional showings, including that the Request is “necessary.” Effectuating that requirement, Commission rule 3010.61(a)(4) requires that exigent requests by the Postal Service include “[a] full discussion of why the requested increases are necessary to enable the Postal Service, under best practices of honest, efficient and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” To make the showing required by 39 U.S.C. § 3622(d)(1)(E) and 39 C.F.R. § 3010.61(a)(4), Nickerson offered an extensive discussion of the Postal Service's liquidity crisis to illustrate “why [the additional contribution requested by the Postal Service] is necessary to ensure that the Postal Service continues to provide prompt, effective, and reliable universal postal



services.” Nickerson Statement at 2. A summary of his testimony on this topic and the Commission’s related analysis is located in Section V.A. *infra*.

Similar to its discussion of liquidity, the Postal Service’s statements concerning postal reform plainly are intended to provide contextual support to the “full discussion” of the various requirements of 39 U.S.C. § 3622(d)(1)(E), as required by the Commission’s rule 3010.61. Those explanations do not, as SMC and Valpak argue, demonstrate that the Postal Service’s Request was made “due to” a lack of postal reform.

Statements made outside the record of this proceeding regarding the Postal Service’s liquidity levels and postal reform are not dispositive here and do not undercut the basis of the Request or the showing the Postal Service attempts to make. As the Postal Service explains, the Board of Governors considered many factors, including the prospect of new legislation and its liquidity levels, before deciding to make the Request. See, e.g., Postal Service Reply Comments at 87, 90-91. The Postal Service’s outside statements are consistent with the Postal Service’s view that the Request is not intended to be viewed “in a vacuum” and are an important part of the “full discussion” provided in response to rule 3010.61.

B. Summary of the Postal Service’s Presentation of the Impact of the Great Recession on Mail Volume

The Postal Service’s estimates of market dominant mail volume losses due to the Great Recession rely on Thress’ econometric demand models and related analyses. These demand equations and analyses attempt to show past changes in mail volumes and predict future changes in volume for particular groupings of mail products and classes. According to Thress, the “estimated exigent impact of the ‘Great Recession’ on Postal Service mail volumes comes out of a set of calculations which underlie all of the Postal Service’s demand equation analysis and volume forecasts.” Thress Statement at 5. The demand equations presented in the current docket have been developed through sets of demand models that had been previously filed with the

Commission. These previous versions of the models include those filed in the original Docket No. R2010-4 and the demand models filed with the Commission in January of each year.<sup>28</sup>

In the current docket, Thress develops separate demand equations for sub-classes of mail. For example, for First-Class Mail, Thress creates three sets of equations: (1) First-Class Single-Piece Letters, Cards and Flats; (2) First-Class Workshared Letters, Cards, and Flats; and (3) First-Class International Letters, Cards, and Flats. In each demand equation, mail volumes are set as dependent variables and are a function of multiple independent variables. These independent variables are different for each demand equation and include macroeconomic variables, price indexes, seasonal variables, dummy variables, trends, and non-linear intervention variables.<sup>29</sup>

The demand equations filed in the current docket have a number of significant methodological differences in comparison with the previously filed demand models. Response to POIR No. 6, question 12. Thress states that one of the major differences is that “the Great Recession is treated as an exogenous event which has had a unique

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<sup>28</sup> See Library Reference USPS-R2010-4-8; Demand Analyses FY 2012 Market Dominant, January 22, 2013; Demand Analyses and Volume Forecast Materials for Market Dominant Products, January 20, 2012.

<sup>29</sup> In Technical Appendix II, Thress provides a brief description of many of the variables he uses in each demand equation. Thress Statement at II1-18. Thress provides the results of his econometric analysis with the obtained coefficients and performed tests in the econometric results output file. Library Reference USPS-R2010-4R-9, folder: Public Econometrics, file: out\_p.txt. Detailed information on the variables directly used in each demand equation can be found in Library Reference USPS-R2010-4R-9, file: RCFDATA.xlsx, tab: “EViews.”

impact on the volumes of specific types of mail.” *Id.* He states that these impacts are modeled through an intervention analysis<sup>30</sup> which he considers “an ideal tool for modeling both the impact of the Great Recession on specific mail volumes as well as modeling the introduction and expansion of the internet and other electronic alternatives to the mail.” *Id.*

Thress’ analysis of mail volume losses due to the Great Recession can be divided into two parts. The first part is his econometric analysis that results in developing a set of demand equations for mail groupings and the volume forecast models. Library Reference USPS-R2010-4R-9. The second part focuses on the identification of factors (so called “sources of change”) that are due to the Great Recession and treated as “exigent circumstances.” The impacts of these exigent circumstances are labeled as “exigent impacts.” Library Reference USPS-R2010-4R-10; Response to POIR No. 6, question 1. Thress determines whether to attribute factors to the Great Recession “on variable-by-variable and equation-by-equation basis.” Response to POIR No. 3, question 2. He asserts that the total impact of the Great Recession on mail volumes is the “sum of the impact of those factors which are judged to be attributable to the Great Recession,” including macroeconomic variables as well as other factors which began to affect mail volumes over the time period associated with the Great Recession. Thress Statement at 5.

To isolate the impact of the Great Recession on mail volume, Thress chooses those variables (or parts of the variables) that he believes reflect volume loss attributable to Great Recession. These variables can be divided into two main

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<sup>30</sup> As Thress explains, “[t]he general term ‘Intervention Analysis’ can be used to refer to any change in the level or trend of mail volumes which starts at a particular time. This can include simple dummy variables, time trends, or the more complicated non-linear Intervention analyses.” Response to POIR No. 4, question 8. In general, intervention analysis focuses on the impacts that “are often unusual or singular.” See Yaffee R.A., Mc.Gee M. Introduction to Time Series and Forecasting: with Applications of SAS and SPSS: Academic Press, 2000 at 265. Thress does not consider all intervention variables as recession related, only those that start coincident with the Great Recession. Response to POIR No. 6, question 1.

categories: (1) macroeconomic variables;<sup>31</sup> and (2) intervention variables and trends.<sup>32</sup> See Response to POIR No. 9, question 3; see *also* Response to POIR No. 3, question 5; Response to POIR No. 6, question 1; Response to POIR No. 7, question 14. Though different for each grouping of mail products and classes evaluated in each demand equation, Thress considers the volume losses identified by the following macroeconomic variables as due to the Great Recession: Employment (total private employment), Retail Sales (total retail sales and mail order retail sales), Investment (real gross private domestic investment), and Foreign Trade (real value of U.S. exports).<sup>33</sup> For many of these macroeconomic variables, Thress divides them into discrete components, using a Hodrick-Prescott Filter (HP Filter). This HP Filter separates macroeconomic variables into a cyclical component and a trend component. Depending on the demand equation, Thress considers volume losses explained by either the cyclical component or trend component of these macroeconomic variables to be attributable to the Great Recession.<sup>34</sup> Thress calculates volumes losses of approximately 16 billion pieces attributable to these macroeconomic variables in FY 2012 alone. Response to POIR No. 3, question 5.

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<sup>31</sup> Macroeconomic variables are based on the exogenous values of macroeconomic factors (such as “employment” or “investment”). As the relevant macroeconomic data changes (such as “employment” or “investment”), mail volume estimated using that macroeconomic data changes. Such macroeconomic variables are based on objective criteria measurements.

<sup>32</sup> The intervention variables and trends refer to any change in the level or trend of mail volumes which starts at a particular time. Response to POIR No. 4, question 8. Such intervention variables and trends are modeled econometrically through mostly endogenous linear time trends or non-linear functions. It is generally not possible to distinguish econometrically between trend influences which are positively affecting mail volume and concurrent trend influences which are negatively affecting mail volume. The variables should, instead, be thought of as capturing the net effect of all trend factors, positive and negative. See Response to POIR No. 1, question 4. A similar issue affects intervention variables. See Tr. 1/100 ( “[I]f there are three things that are moving in the exact same direction of the exact same magnitude over the exact same period of time, there’s nothing you can do with that econometrically. You can get an overall estimate.”).

<sup>33</sup> See Library Reference USPS-R2010-4R-9; DataDictionary.docx.

<sup>34</sup> Thress sometimes uses both the cyclical and trend components in the same demand equations, or even raw data.

In addition to these macroeconomic variables, depending on the demand equation, Thress attributes certain intervention variables and trends<sup>35</sup> to the Great Recession. Response to POIR No. 7, question 14. According to Thress, the volume losses attributable to these intervention variables and trends are due to the Great Recession because, among other reasons, they began around the time of the Great Recession and the Great Recession was the cause of the volume losses associated with these intervention variables and trends. Thress Statement at 5.<sup>36</sup> Thress calculates volume losses of 37.5 billion pieces attributable to these intervention variables and trends in FY 2012 alone. Response to POIR No. 3, question 5.

In terms of the time period for measuring the impact of the Great Recession on the Postal Service's mail volumes, the Postal Service starts its measurement in FY 2008 and ends its analysis with FY 2012. The Postal Service asserts that due to the variables identified by Thress as due to the Great Recession, it lost 53.5 billion pieces in FY 2012 alone. Request at 11. Cumulatively, the Postal Service asserts that it lost 189.7 billion pieces from FY 2008 through FY 2012 due to the Great Recession. Response to POIR No. 6, question 16.<sup>37</sup> The Postal Service's forecasts predict that it will lose an additional 58.8 billion pieces and 63.9 billion pieces in FY 2013 and FY 2014 respectively due to the Great Recession. Response to POIR No. 6, question 14. The Postal Service does not foresee an end date for the impact "due to" the Great Recession. Thress stated at the hearing that it could be 20 years or longer from now. Tr. 1/103-04.<sup>38</sup>

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<sup>35</sup> Thress explains that the intervention variables and trends are based on "other factors which began to affect mail volumes over the time period associated with the Great Recession." Thress Statement at 5.

<sup>36</sup> Response to POIR NO. 6, question 1. (This type of volume loss "presents the impact of intervention variables [and trends] which beg[a]n coincident with the onset of the Great Recession and which [either] attenuate to a consistent long-run level" or "take the form of linear trends.").

<sup>37</sup> For a more complete discussion of this topic, see the discussion at section IV.D.3, *infra*.

<sup>38</sup> Thress states that he believes "the cumulative negative impact of the Great Recession will continue for the foreseeable future." Response to POIR No. 1, question 6.

C. Summary of Comments on the Postal Service's Presentation of the Impact of the Great Recession on Mail Volume

*MPA.* MPA, supported by its Lundblad Statement, argues that the Postal Service has failed to meet its burden of proof in this case to demonstrate the amount of volume losses that were due to the Great Recession. MPA asserts that Thress' claim that essentially the entire net decline in volume between FY 2007 and FY 2012 estimated using his intervention variables and trends was caused by the Great Recession is implausible. MPA argues that the entirety of the impact of all of these intervention variables and trends should be excluded from the estimates of volume losses due to the Great Recession. MPA Comments at 21-42. MPA asserts that Thress' assumption that all of these intervention variables and trends are due to the Great Recession since they began around the time of the beginning of the Great Recession is false. *Id.* at 25. MPA criticizes Thress for not using cyclical variables to explain the volume loss due to the Great Recession and other explicit variables to measure electronic diversion. *Id.* at 28. MPA contends that because recessions are cyclical events, estimates of their impact should be based on cyclical variables, not trend variables as used in Thress' intervention analysis for certain demand equations. *Id.* at 27. MPA makes five additional arguments against using Thress' intervention analysis for measuring volume losses due to the Great Recession. MPA Comments at 28-43.

First, MPA argues that Thress' assumption that the underlying rate of electronic diversion has held constant or slowed since 2007 is unsupported. *Id.* at 30. It asserts that Thress does not properly account for the fact that the internet is not a single event, but rather "a succession of derivative or complementary innovations, each with its own S-curve,<sup>39</sup> that build on earlier innovations in the field." MPA Comments at 30-31.

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<sup>39</sup> An "S-curve" is the typical response of consumers to adopting new technology. Response to POIR No. 6, question 25. According to Thress, "[a]n s-curve adoption pattern begins slowly with tentative initial adoption by 'early adopters' before an inflection point which leads to a period of rapid adoption. Eventually, the rate of adoption begins to approach its ceiling level, at which point the rate of adoption attenuates significantly before eventually plateauing." *Id.*

Second, MPA contends that there is no evidence supporting Thress' speculative assertion that the decline in mail volume after 2007 was caused by the Great Recession. *Id.* MPA notes that businesses look to cut costs continually, not just during recessions. In support of this contention that businesses are not finding the Great Recession an impetus to shift to electronic communications, MPA points out that businesses' attempts to replace mail with electronic communications typically require large upfront costs which are not available during recessions. *Id.* at 35.

Third, MPA argues that Thress' attempt to attribute the decline in advertising mail to the Great Recession due to decreases in advertising spending is incorrect because the main reason for the decline during this period was a migration to the internet and other non-mail channels. MPA Comments at 37;<sup>40</sup> Lundblad Statement at 18-20; Swallen Statement at 2-3.

Fourth, MPA contends that Thress' attempt to blame the Great Recession for the decline in billing and bill payments since 2007 is unsupported. MPA Comments at 39. MPA notes that the percentage of bills paid and presented electronically has increased and that 24/7 access to account information has reduced the need to send monthly statements. MPA also cites the Postal Service's own Household Diary Study showing that the total number of bills that households actually pay was "virtually unchanged" during the relevant period. *Id.* at 41.<sup>41</sup>

Fifth, MPA contends that the difference between the actual total Gross Domestic Product (GDP) and potential GDP is not related to mail volume losses, rather it is related to "hypothetical gains," which are not eligible for recovery as due to the Great Recession. MPA Comments at 43.

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<sup>40</sup> MPA notes that internet advertising revenue multiplied 6 times from 2002 to 2012 to approximately \$37 billion in 2012. *Id.*

<sup>41</sup> MPA also shows that while the rate of household formation may have slowed, the number of households in the United States continued to grow through the Great Recession and is higher today than in 2007. *Id.* at 42.

MPA also conducts a risk exposure analysis to estimate the impact of changes in macroeconomic variables on mail volumes. MPA contends that its analysis shows that the impact of macroeconomic variables on mail volumes was much milder than the Postal Service asserts.<sup>42</sup> MPA thus believes that electronic diversion and other long-term trends were the primary cause of the decline in mail volume rather than the Great Recession.

Additionally, MPA asserts that Thress' analyses related to intervention variables and trends suffer from methodological flaws that overstate the effect of the Great Recession. MPA argues that Thress' model improperly skews the results by counting the negative effects of the Great Recession only, and excluding the positive effect of the post-recession recovery. MPA Comments at 3, 44; Lundblad Statement at 4-5, 22-23, 38-42. MPA contends that the recovery period is an integral part of the business cycle and may "not be simply assumed away." MPA Comments at 44. Also, MPA asserts that Thress' macroeconomic variables improperly include a trend component. MPA argues that only the cyclical component of the macroeconomic variables should be used in determining the impact of the Great Recession on mail volumes. MPA Comments at 3, 44-48; Lundblad Statement at 4-5, 27-32, 38-42. It asserts that the trend

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<sup>42</sup> Thress argues that this risk exposure analysis is flawed because it fails to account for the fact that the Great Recession was "exceptional and extraordinary." Thress Reply Statement at A-4. MPA's risk exposure analysis method for verifying its estimate of the effects of the Great Recession on mail volume is to regress the year-to-year growth rates for two postal volume series individually on the year-to-year rates of change of four macro-economic indicators. Lundblad describes this method as "a well-established technique used in macroeconomics and finance for estimating the extent to which the earnings of an enterprise are exposed to the risk of potential macroeconomic events." Lundblad Statement at 32. Each one of these simple regressions results in a linear transformation that allows for the combination of the rate of change of the macroeconomic indicator and a linear trend to approximate the rate of growth of a postal mail volume series. Basically, this method provides a way to transform the rate of change in the macroeconomic indicators so that they can all be displayed in the same graph along with the rate of change in the postal mail volume series. See Lundblad's Figures 9 and 10 as examples. Lundblad Statement at 36-37.

This risk exposure method is a helpful way to display data but does not lead to quantitative estimates of the effects of the various macroeconomic variables on postal mail volumes. Rather, a structural demand model is necessary. The results of Lundblad's simple regressions cannot be construed as an econometric fit of a demand equation. Therefore, this method cannot be used in place of an econometric demand model.



component of these macroeconomic variables reflect slow moving effects associated with labor force growth and productivity, and, as such, are unrelated to the Great Recession. *Id.* Finally, MPA asserts that Thress' regression methodology fails to adequately deal with non-stationarity of data, "spurious regressions,"<sup>43</sup> and improperly picks the trend start dates, functional forms, and optimization procedures that best fit the data each year.

Correcting for these asserted shortcomings, MPA and Lundblad have modified Thress' spreadsheets to: (1) eliminate his "arbitrary interpretation" of the intervention variables and trends in his equations as Great Recession-related; (2) include the positive effects of economic recovery in calculating the overall effect of the Great Recession; and (3) exclude the trend component of macroeconomic variables from the calculation of the volume losses attributable to the Great Recession. MPA Comments at 8. The following table contains MPA's estimate of volume losses due to the Great Recession:

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<sup>43</sup> These regression methodology criticisms appear to be adequately rebuffed in Thress' reply statement. Thress notes that the Durbin-Watson statistic that evaluates the time series for non-stationarity, and which was estimated for his demand equations, do not provide any evidence of spurious regressions. Thress Reply Statement at A2-4.

**Table IV-1**

**MPA Estimates of Year-over-Year Changes in Mail Volumes  
due to the Great Recession  
(Market Dominant Mail only in Millions of Pieces<sup>44</sup>)**

<u>MPA/Lundblad's estimates</u>							
	<u>FY2008</u>	<u>FY2009</u>	<u>FY2010</u>	<u>FY2011</u>	<u>FY2012</u>	<u>FY2008-FY2009</u>	<u>FY2008-FY2010</u>
First-Class Mail (domestic)	118.8	(1,087.1)	(458.5)	355.6	313.6	(968.3)	(1,426.8)
Standard Mail	(2,341.0)	(8,562.3)	1,359.3	872.0	2,477.0	(10,903.2)	(9,543.9)
Periodicals Mail	(110.3)	(377.2)	(352.3)	(15.8)	66.3	(487.4)	(839.7)
Package Services	3.1	(3.4)	7.0	9.2	7.2	(0.3)	6.7
First-Class Mail (international)	11.3	(17.2)	13.2	7.2	2.9	(5.8)	7.3
<b>TOTAL MARKET-DOMINANT MAIL</b>	<b>(2,318.0)</b>	<b>(10,047.1)</b>	<b>568.7</b>	<b>1,228.2</b>	<b>2,867.0</b>	<b>(12,365.1)</b>	<b>(11,796.4)</b>

*Public Representative.* The Public Representative argues that Thress does not establish a satisfactory link between the Great Recession and the claimed financial outcomes due to it. He asserts that Thress overestimates volume losses due to exigent circumstances by counting volume changes occurring during times in which the Postal Service was making operational changes to reduce the impact of unexpected volume losses. Additionally, he contends that Thress overestimates mail volume losses due to the Great Recession by omitting variables that could directly measure mail lost due to internet diversion and by including variables whose effect should not be considered as due to the Great Recession.<sup>45</sup>

With respect to the Postal Service's choice of macroeconomic variables, the Public Representative argues that Thress' approach is flawed due to its lack of consistency. For some products he uses the "raw" or unfiltered macroeconomic variables for attributing losses to the Great Recession. For others, he separates the variables through an HP Filter and inconsistently uses either the trend or cyclical

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<sup>44</sup> More detailed calculations and results are provided in Library Reference MPA et al.-LR-R2013-11-1, file: "MPA et al.-LR-R2013-11-1-Improved Approach.xlsx." MPA also estimates FY 13 and FY 14 impacts.

<sup>45</sup> The Public Representative asserts that a proper analysis of diversion requires explicit measurement of internet diversion through explanatory variables that take into account internet-related items such as PayPal and the growth in wireless traffic. PR Comments at 31-34.

components for attributing losses to the Great Recession. PR Comments at 25-26.<sup>46</sup> The Public Representative submits that the volume losses attributable to the cyclical component of a macroeconomic variable should not be used in determining the impact of the Great Recession. PR Comments at 27.

The Public Representative asserts that only the “shock” or initial pulse<sup>47</sup> of the Postal Service’s intervention variables and trends represent exigent circumstances due to the Great Recession. PR Comments at 28. Therefore, he contends that the impact of the trends and the “step” part of the intervention variables and trends should not be considered in the estimation of mail volume losses attributable to the Great Recession. The Public Representative also takes issue with the Postal Service’s computation of Postal Service losses in individual years as opposed to the asserted cumulative losses. *Id.*

The Public Representative attempts to correct the problems he identifies by revising mail volume estimates based on Thress’ model. The following table contains the Public Representative’s estimate of volume losses due to the Great Recession:

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<sup>46</sup> For some demand equations, Thress uses both the cyclical and trend components. In one demand equation, the Public Representative notes that Thress uses the raw values and the filtered values. PR Comments at 25.

<sup>47</sup> Non-linear intervention variables sometimes include a pulse function or a step function. Thress Statement at II 8. Pulse functions are typically employed if the events are expected to be temporary and decay over time. Step functions typically model more prolonged events. See, e.g., Cleary J.P., Levenbach H. *The Professional Forecaster: the Forecasting Process through Data Analysis*. Wadsworth, Inc. 1982, at 332-336.

**Table IV-2**

**Public Representative Estimates of Year-over-Year Changes  
in Mail Volumes due to the Great Recession  
(Market Dominant Mail only in Millions of Pieces<sup>48</sup>)**

<b>Public Representative's Estimates:</b>	<b>FY2008</b>	<b>FY2009</b>	<b>FY2010</b>	<b>FY2011</b>	<b>FY2012</b>	<b>FY2013</b>	<b>FY2008-FY2012</b>
First-Class Mail	(712.9)	(759.7)	(597.9)	(315.5)	(68.1)	0.0	(2,454.1)
Standard Mail	(2,447.0)	(8,458.9)	(56.9)	0.0	0.0	0.0	(10,962.8)
Periodicals Mail	(167.2)	(190.9)	(150.7)	(83.1)	(18.8)	0.0	(610.7)
Package Services	(0.4)	(3.4)	0.0	0.0	0.0	0.0	(3.7)
<b>TOTAL MARKET-DOMINANT MAIL</b>	<b>(3,327.4)</b>	<b>(9,413.0)</b>	<b>(805.5)</b>	<b>(398.5)</b>	<b>(86.9)</b>	<b>0.0</b>	<b>(14,031.4)</b>

GCA. GCA, supported by the Clifton Statement, asserts that: (1) volume losses occurring after the “official” end of the Great Recession in June 2009 should not be counted as “due to” the Great Recession; and (2) the alleged increase in diversion (represented by Thress’ third trend line beginning in 2007 for Single-Piece First-Class Mail) has neither been shown to exist, nor to have been caused by the Great Recession and not some other factor such as increased ability to use e-media. GCA Comments at 8-20. GCA argues that the Postal Service has not met its burden for showing a causal connection by historical inquiry between the intervention variables and trends and the impact of the Great Recession. *Id.* at 10-11, 15. GCA contends that at best the Postal Service has proven that “an increase in diversion happened more or less coincidentally in time with the onset of the Great Recession.” *Id.* (footnote omitted). GCA explains that the diversion captured by Thress’ intervention variables and trends could be due to “the explosion of new and diversely functional electronic devices.” *Id.* at 13.

GCA and Clifton attempt to demonstrate through statistics and econometrics that Thress’ intervention trend for Single-Piece First-Class Mail that begins in 2007Q4 is improper. *Id.* at 15-20; Clifton Statement at 20-28. Rather, according to GCA and Clifton, there should be no new trends beginning as of that date. *Id.* The Clifton

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<sup>48</sup> The impact of the Great Recession on First-Class International Letters, Cards and Flats was omitted from the Public Representative’s calculations. See Library Reference PR-R2013-11-LR1.

Statement further contends that Thress' employment variable and his use of the HP Filter distorts the results of the amount of volume loss that is due to the Great Recession. For example, Clifton attempts to show that Thress' HP Filtered employment variable indicates losses during the same time window when the Bureau of Labor Statistics' employment figures and GDP numbers increase. Clifton Statement at 29-33.<sup>49</sup>

*NPPC.* NPPC asserts that the Postal Service's showing of losses due to the Great Recession is defective because the Postal Service: (1) does not limit its claims to volume losses that occurred during the Great Recession, but rather bases its claims on volume losses "allegedly lost" during the third year of the economic recovery; and (2) relies exclusively upon an econometric demand estimation model – which itself has required frequent tinkering – and which depends on unreasonable assumptions "outside the model" about the rate of electronic diversion in recent years that conflict with the experience of actual mailers. NPPC Comments at 8-9. NPPC argues that Thress' demand models make assumptions about the rate of electronic diversion that are inconsistent with its own modeling difficulties, are unreasonable, and contrary to mailer experience. In essence, NPPC asserts that the Postal Service improperly assumes that the rate of electronic diversion has continued unchanged "but for" the Great Recession. NPPC Comments at 15.

First, NPPC contends that the Postal Service's assumptions ignore its long history of problems with modeling diversion. *Id.* Second, it argues that the assumptions ignore changes in technology that have occurred in recent years such as the iPhone, Facebook, Twitter, mobile applications, and wireless broadband. *Id.* at 20-24.<sup>50</sup> Third,

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<sup>49</sup> In response to this argument, Thress asserts that Clifton is not properly reviewing the employment data along with population data. Thress asserts that if both sets of data are reviewed concurrently, then there is nothing unusual about the relationship between First-Class Single-Piece Mail and Employment within the Postal Service's model. Thress Reply Statement at A19-20.

<sup>50</sup> NPPC also asserts that the assumptions are counterintuitive in the sense that they show the effects of the Great Recession "deepen the longer the [Great R]ecession recedes into history." NPPC Reply Comments at 4.

NPPC asserts that the assumptions are contrary to mailers' experiences. *Id.* at 24-26 (citing Buc Statement at 4). In support of these criticisms, NPPC filed a supporting Buc Statement involving empirical interviews and surveys. Buc's interviews and surveys found no empirical support for the proposition that the recession caused an increase in electronic diversion. Buc Statement at 19-25. Rather, Buc found that mailers increased their use of electronic media as consumers acquired better technology and became more comfortable using such technology for transactions. *Id.*; see also NPPC Comments on Buc Statement at 3-4.

*Valpak.* Valpak argues that: (1) Thress' estimated decline in Standard Mail volume due to the Great Recession "grossly overstates" the actual declines;<sup>51</sup> and (2) the assumed scenario from which volume losses are estimated is "supremely optimistic" and "fundamentally flawed." Valpak Comments at 26-48. Valpak asserts that if the Commission were to determine that some amount of losses due to the Great Recession were recoverable, it should not allow recovery for: (1) theorized losses of mail volume due to the Great Recession that exceed actual loss of mail volume; (2) losses that would occur during a "normal" recession; and (3) losses that occur more than one year outside the time span of the official end of the Great Recession in June 2009. *Id.* at 44.

*FSR and NAMIC.* FSR and NAMIC assert that the Postal Service has not met its burden of proof in this case. They contend that the Postal Service did not make the required showing of a causal nexus between the exigent circumstance and the asserted volume loss due to that circumstance. They believe that the Postal Service has not sufficiently untangled the effects of the Great Recession from those attributable to technological advances that have driven communication into the digital sphere.

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<sup>51</sup> On reply, Thress argues that it is improper to compare the models to the actual declines. Rather, what should be done to judge the reasonableness of the estimates is to see what the estimates imply would have occurred in the absence of the Great Recession and see if those estimates make sense. Thress Reply Statement at A22-26.

*SIIAM and ABM.* SIIAM and ABM “strongly and fully” support the MPA comments and the manner in which they detail why the Postal Service’s exigent rate filing should be modified and limited such that the rate increase is in line with the actual economic losses from the Great Recession.

*Valassis.* Valassis endorses MPA’s comments regarding: (1) the responsibility of the Great Recession for Postal Service volume losses in FY 2012; (2) the continuing reliability of the Postal Service’s econometric models; and (3) the questionable validity of the adjustments made in these models to force the models to fit recent market conditions.

*Boardroom.* Boardroom supports other commenters’ arguments that the Postal Service’s demand model does not properly distinguish between price sensitivity and electronic diversion and is not based on sufficient data.

*ABA.* ABA argues that the Postal Service faced significant challenges posed by electronic diversion, and that this diversion is based upon technological advances and not the Great Recession. ABA Reply Comments at 3. ABA further contends that the Postal Service’s argument that virtually all of the volume losses since 2007 are attributable to the Great Recession conflicts with ABA’s members’ experiences. ABA reports that its members indicate that increased electronic diversion during and after the Great Recession are generally due to reasons other than the Great Recession. ABA Comments at 3-5.

*Senator Collins.* Collins asserts that virtually all of the losses claimed by the Postal Service result from the effects of electronic diversion in FY 2012, not the Great Recession. She argues that to allow recovery of such diversion-related losses would be at odds with ongoing changes in Americans’ use of technology.

*NPMHU.* NPMHU supports Thress’ demand models and corresponding volume loss quantifications attributable to the Great Recession. It asserts that although other commenters’ criticisms may “nibble away at the edges” of Thress’ quantification of

volume losses due to the Great Recession, there is nothing to suggest that his calculations are erroneous to the magnitude necessary to bring the losses attributable to the Great Recession below the \$1.78 billion annual rate adjustment sought by the Postal Service in this case. NPMHU Comments at 2-5. It asserts that if the Commission is not persuaded by the Postal Service's entire case, the Commission should exercise its authority to approve some portion of that increase. NPMHU Reply Comments at 2.

*Postal Service.* The Postal Service, supported by its Thress Reply Statement, attempts to show that its estimates of the impact of the Great Recession are more reasonable than the alternatives and arguments presented by the commenters. Postal Service Reply Comments at 3-70; Thress Reply Statement at 2-36. Thress argues that the rate of technology-based diversion implied by Lundblad's analysis is implausibly large. *Id.*

#### D. Commission Analysis

Due to the length and complexity of the matters raised by the Postal Service's Request and the comments regarding the "due to" requirement, the Commission reviews these topics on an issue-by-issue basis. As part of this discussion, the Commission makes relevant findings and presents analysis related to the impact of the Great Recession on mail volumes. First, the Commission reviews the Postal Service's attempt to econometrically model the impact of the Great Recession on mail volumes. Second, the Commission considers the appropriate time period for recognizing the impact of the Great Recession on mail volumes. Third, the Commission considers whether to cumulatively quantify the impact of the losses. Fourth, the Commission considers the economic baseline from which to calculate the measurement of the change in volume due to the Great Recession. Fifth, once these issues are determined and appropriate findings are made, the Commission quantifies the impact of the Great Recession on mail volumes. Finally, the Commission converts its calculations of this



impact on mail volumes into a lost contribution dollar amount that the Postal Service is eligible to recover through above CPI rate increases.

1. Modeling the Impact of the Great Recession

At the heart of the Postal Service's case is its attempt to econometrically model the impact of the Great Recession on mail volumes. Commission Order No. 864 directed the Postal Service to quantify the net adverse financial impact of the exigent circumstances by factoring out the financial impact of non-exigent circumstances, such as the continuing effects of electronic diversion. The Commission stated that "this process ensures that an exigent rate adjustment is limited to the adverse effects of the exigent circumstances as opposed to other, non-exigent factors." Order No. 864 at 48. In this proceeding the Postal Service provides an econometric model that purports to distinguish between volume loss due to the extraordinary or exceptional circumstance and volume loss due to other factors.

According to the Postal Service, the "exigent request filed by the Postal Service in this proceeding employs the same procedures long used by the Postal Service to forecast mail volumes." Postal Service Reply Comments at 66. The model is essentially a modified forecasting model.<sup>52</sup> The central question before the Commission is to what extent the Postal Service model correctly identifies volume loss due to the extraordinary and exceptional circumstance. A secondary but related question is to what extent a model developed to forecast future volumes can be used to isolate the cause of a singular event.

The basic econometric method generally used to measure the impact of an effect on postal volumes, such as the Great Recession, is to compare two back casts made

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<sup>52</sup> Compare Library Reference USPS-R2010-4-8 with Demand Analyses FY2012 Market Dominant, January 22, 2013 and Demand Analyses and Volume Forecast Materials for Market Dominant Products, January 20, 2012.

with the model.<sup>53</sup> The first is done with the causes of the effect present. The second is done with the causes of the effect absent. The impact of the effect is measured as the difference between the two back casts. Usually, the first back cast is made simply using values for the independent variables drawn entirely from the sample. For the second back cast, the values of the independent variables are changed or omitted to remove the impact of the specific effect. Estimating effects in this way is a conventional use of econometric models and, when done properly, leaves both an estimate of the effect and a statistical statement, such as a confidence interval, of the reliability of the estimate.

To measure the impact of an effect in a reasonably accurate manner, the econometric demand model should be reasonably complete and correctly specified with respect to all of the basic determinants of demand. In particular, the econometric model should not omit or misrepresent structure that pertains to the impact of the effects to be measured. The variables that represent the effects should be chosen, as much as possible, so that they can be unambiguously stipulated for the back casts. The model should be fit to a suitable sample using appropriate methods.<sup>54</sup> The parameters associated with the explanatory variables of interest need to be estimated with enough precision to produce back casts that are statistically reliable. The econometrics should not only allow an estimate of the effects, but also provide information about the reliability of the estimates.

Thress estimates his demand equations using an econometric forecasting model. In the demand equation developed for each mail category, postal mail volume is set as a function of multiple independent variables. For each demand equation (developed using EViews software), Thress provides the econometric output that lists the

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<sup>53</sup> “Backcasting” is essentially forecasting backwards. It is a reverse forecasting technique that starts with a specific outcome and then works backwards in an attempt to determine the causes of that outcome. While postal econometric forecasts usually attempt to predict future mail volume using specified values for the independent variables, a postal econometric back cast attempts to predict the causes of past mail volume losses from the model using specified values for the independent variables.

<sup>54</sup> See *generally* William H. Greene, *Econometric Analysis* (7th ed. 2011).

independent variables included in the equations, the values of the estimated coefficients and the results of statistical tests. This information is transparent. Thress' demand equations show a good fit and statistical reliability of the provided estimates.

However, as Lundblad points out, having too good a fit could be an indication of serious flaws. Lundblad Statement at 23-24, 26 n.14. The Commission has identified several flaws in the econometric analysis performed by Thress, primarily related to the selection of variables. First, the model is misspecified<sup>55</sup> with respect to an important determinant of demand, electronic diversion. The variables chosen by Thress make it difficult to estimate the effects of the Great Recession because they do not cleanly separate the effects of economic activity from electronic or other diversion.

Second, Thress' model is incomplete with respect to its choice of macroeconomic variables. Thress identifies "several macro-economic variables, most of which have obvious implications for mail volume, which were at, near, or even below their Great Recession low points in 2012 or 2013." Response to POIR No. 9, question 2. While these macroeconomic factors may have an impact on mail volume, they are not incorporated into his model.

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<sup>55</sup> In econometrics, it is assumed that the economic theory provides a "true" specification of the demand equation to be estimated. If the economic theory, specified by the variables in the equation, is incomplete, the estimated parameters will be biased. A misspecified model contains bias parameters. Since Thress could not fit exogenous variables that explain diversion, he includes the Intervention variables and trends in his demand model equations as endogenous variables to minimize bias. See e.g., Response to POIR No. 9, question 7.

Third, the Postal Service relies heavily on “curve-fitting techniques”<sup>56</sup> such as dummy variables,<sup>57</sup> trends over selected periods of time, and intervention variables to fit the demand equations. While these variables enable a fitted demand equation to better approximate changes over time, it is usually impossible to unambiguously set values for these variables for back casts. In this instance, these curve fitting techniques conflate the effects of the Great Recession with other factors, such as the growing impact of electronic diversion and the adaptation of postal customers to new market conditions, which impacted postal volumes contemporaneously with the Great Recession. These flaws in the econometric analysis are discussed in more detail below.

a. Exclusion of Variables that Directly Measure Electronic Diversion

It is particularly important that electronic diversion of mail volumes be adequately represented in demand equations that are to be used to estimate the effect of the Great Recession because it is electronic diversion that is most likely to be mistakenly attributed to the Great Recession by an incorrect model. Unfortunately, the model on record in this proceeding represents electronic diversion in an inferior manner.

Thress’ demand equations do not employ any variables that directly measure the growth of the internet or its usage over the time period explored in his models.

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<sup>56</sup> Curve fitting techniques are variables that are included for the purposes of improving statistical fit. Lundblad criticizes Thress for not applying sensitivity analysis in choosing his macroeconomic and trend variables and hiding “the choice between included and excluded variables.” Lundblad Statement at 23-24. As Lundblad states, the reliable explorations of different choices “would have to reflect the many different candidate specifications that were considered but not shown.” *Id.* at 24. In the current docket, Thress has provided the econometric outputs of the rejected demand equations for First-Class Single-Piece Letters, Cards and Flats. *Id.*

<sup>57</sup> Dummy variables are variables that can have a value of either 1 or 0. In a demand equation, dummy variables are included to indicate if a certain event happened or not, or if a certain attribute is applicable or not. Although inclusion of dummy variables might increase the “fit” of the regression model, presence of dummies in the model might degrade its robustness. See, e.g., Blankmeyer E. How Robust Is Linear Regression with Dummy Variables? November 2006. <https://digital.library.txstate.edu/bitstream/handle/10877/4105/fulltext.pdf>.

Instead, the diversion of mail to the internet and other electronic alternatives is modeled through the inclusion of intervention variables and trends starting at distinct time periods depending on particular grouping of mail.<sup>58</sup> Thress calculates the volume loss associated with intervention variables and trends beginning in quarter 1 of FY 2008 as due to the Great Recession rather than electronic diversion. As GCA points out, Thress has altered the analysis that was provided in the Postal Service's original exigency filing. In that case, the analysis directly attributed these intervention variables and trends to electronic diversion rather than the Great Recession.

The Commission agrees with the commenters that the growth of the internet and electronic diversion shares in the responsibility, along with the Great Recession, for the decline in mail volumes since quarter 1 of FY 2008. Econometric methods could be used to separate the impact of the Great Recession from electronic diversion if diversion and economic activities are properly represented in the equations and if the equations are fit to a long enough sample.

For example, three direct measures of internet penetration are shown in the graph below. These are the share of U.S. households with a broadband connection,<sup>59</sup> the proportion of Federal Reserve transfers that are electronic,<sup>60</sup> and the share of the population of developed countries with internet access.<sup>61</sup> The "Broadband Squared" curve shows the proportion of all two-way connections between households that are

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<sup>58</sup> NPPC contends that the Postal Service's assumptions ignore its long history of problems with modeling diversion. The Commission notes that forecasting volumes is a different responsibility than taking volumes and trying to determine why certain things happened in the past. Put another way, volume forecasting does not necessarily need to know why volumes change; it only needs to accurately predict how they will change. The Commission's exercise in this case is to determine, with known volumes, how much of those volumes are explained by various factors. Nonetheless, the absence of an accurate term for forecasting diversion is consistent with the failure to identify such a term in this case.

<sup>59</sup> Source: The Leichtmann Research Group (broadband subscriptions) and the U.S. Bureau of the Census (number of households).

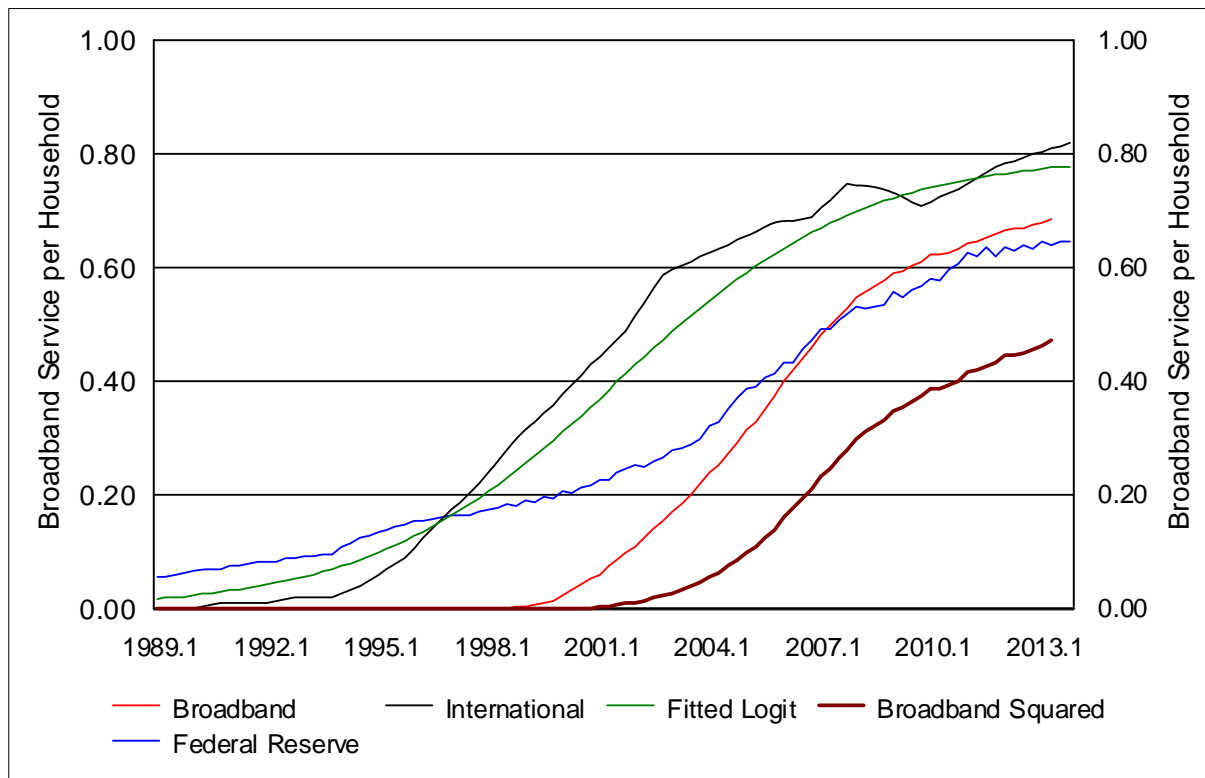
<sup>60</sup> Source: Federal Reserve – Commercial checks collected through the Federal Reserve at [www.federalreserve.gov](http://www.federalreserve.gov).

<sup>61</sup> Source: International Telecommunication Union, World Telecommunication/ICT Development Report and database, and World Bank estimates.

possible with broadband. Finally, a fitted logistic curve<sup>62</sup> exhibits the traditional S-curve path that the demand for a new product characteristically follows.

**Figure IV-1**

**Internet-Assisted Diversion**



Thress concedes that he has not even considered or explored measuring internet diversion through increases in computing power, differences in broadband speeds, or other measures related to advances in communications using the internet such as smartphones. Although previous versions of the forecasting model used the number of broadband connections successfully, Thress now claims that such an effort would be fruitless, because such a variable or variables “cannot exist.” He explains that,

<sup>62</sup> The equation for the logistic curve is  $y = 0.8 \cdot \exp(0.3 \cdot t) / (1 + \exp(0.3 \cdot t))$ . In this equation, “y” is the share of adapters at time “t” which is measured in years from July 1, 2001. The 0.3 is the rate of adaptation and the 0.8 is the proportion of adapters as time “t” gets large.

Just because a variable includes the word "Internet" in its name or because it is constructed from a measure of Internet usage for the purpose of isolating the impact of the Internet on mail volume does not mean that the variable will, in fact, fully capture the impact of the Internet on mail volume and nothing else....

This was true for the Internet usage variables that used to be included in the Postal Service's econometric demand equations. These variables were not simply identifying specific diversion due to the increasing use of Broadband, but would have also picked up more general diversion trends due to general technological advancements which happened to correlate well with the growth of broadband.

Response to POIR 9, question 7.

The Commission agrees that there may not be one specific variable that would perfectly capture electronic diversion. However, Commission Order No. 864 directed the Postal Service to quantify the net adverse financial impact of the exigent circumstances by factoring out the financial impact of non-exigent circumstances. Consequently, even if a variable or set of variables constructed to capture the impact of the internet was capturing broader technological advances the impact would be properly attributed to non-exigent circumstances.

In his model submitted in this case, Thress does not include a variable or variables that attempt to directly measure internet or electronic diversion. No commenter offered an econometric model that included such a variable. For the Commission to include such a variable in its analysis at this point would require re-specifying the model. Doing so would likely alter the relationships of the existing variables and result in a completely new model not supported by the record evidence. Consequently, this record is void of an econometric model that clearly separates the impact of internet or electronic diversion on mail volume. Thress' contention that his trends accurately identify causality of volume declines with the Great Recession is not justified.

b. Choice of Macroeconomic Variables

Depending on the type of mail, Thress uses different macroeconomic variables in his demand equations. For certain macroeconomic variables, he uses an HP Filter to transform them into two components: a cyclical component and a trend component. In all of his demand equations, Thress treats all negative changes in these macroeconomic variables, including those HP Filtered macroeconomic variables as due to the Great Recession. Following this methodology, Thress estimates mail volume losses due to the Great Recession caused by the following macroeconomic variables, separated by market dominant grouping of mail:

**Table IV-3**

**Macroeconomic Variables Used In Demand Equations, by Subclass**

Class	Subclass	Macroeconomic Variable Used In Demand Equation
<b>First Class</b>	Single Piece Letters, Cards, and Flats	Trend Component of Employment
<b>First Class</b>	Workshared Letters, Cards, and Flats	Cyclical Component of Employment
<b>First Class</b>	International Letters, Cards, and Flats	Real Exports
<b>Standard</b>	Regular Mail	Investment
<b>Standard</b>	Enhanced Carrier Route Mail	Investment
<b>Standard</b>	Nonprofit Mail	Trend Component of Investment
<b>Standard</b>	Nonprofit Enhanced Carrier Route Mail	Cyclical Component of Investment
<b>Periodicals</b>		Trend and Cyclical Component of Employment
<b>Package Services</b>	Bound Printed Matter	Retail Sales
<b>Package Services</b>	Media and Library Mail	Retail Sales

Thress Statement at Appendix II; Response to POIR No. 3, question 2; Library Reference USPS-R2010-4R/10.

Thress does not include any other macroeconomic variables in his demand equations. However, he identifies “several macro-economic variables, most of which have obvious implications for mail volume, which were at, near, or even below their Great Recession low points in 2012 or 2013.” Response to POIR No. 9, question 2. In particular, he cites: (1) the decline in real median household income; (2) a low level of real advertising expenditure; (3) a decline in the level of home ownership; (4) a



slowdown in the rate of household formation; (5) a lower number of new credit card accounts compared to closed credit card account; (6) a decline in mortgage loan and home equity loan accounts; and (7) an “output gap” between actual total GDP and potential GDP. *Id.*; Response to POIR No. 1, question 6.

Thress’ argument for attributing mail volume losses to the Great Recession based on these factors is, as the Postal Service concedes, “largely circumstantial.” Postal Service Reply Comments at 57. While these macroeconomic factors may have an impact on mail volume, none has been shown here. If Thress had incorporated these (or other) Great Recession related macroeconomic factors as independent variables into his models and shown a statistical correlation between such macroeconomic variables and mail volume, the Postal Service would have demonstrated a quantifiable relationship. Based on such a statistical relationship, the Postal Service could have attributed mail volume losses based on these variables to the Great Recession. However, these economic factors are just listed as circumstantial support of intervention variables and trends. No proper statistical correlation has been shown between any of these economic factors and mail volume. No impact on mail volume has been shown at all with respect to any of these macroeconomic factors. Accordingly, the Commission cannot attribute mail volume losses to the Great Recession based on those macroeconomic factors that were not included in Thress’ models.

On a related issue, commenters disagree as to whether it is appropriate to attribute the positive effects of macroeconomic variables to the Great Recession once the values of such variables turn positive. MPA argues that the recovery period is an integral part of the business cycle and may “not be simply assumed away.” MPA Comments at 44. GCA agrees. GCA Reply Comments at 6. In response to this criticism, Thress argues that “these gains in mail volume are not ‘due to the Great Recession’; they are, instead, an indication that the negative impact of the Great Recession has abated in some sectors of the economy.” Response to POIR No. 1,

question 6; Postal Service Reply Comments at 35-36 (arguing that counting the positive effects would “lead to an *understatement* of the loss of mail volume due to the Great Recession”) (emphasis in original).

The Commission agrees with MPA that in calculating the impact of the Great Recession on mail volume losses for each subclass of mail, both the positive and negative impacts of the macroeconomic variables should be reflected. See Lundblad Statement at 38. The task at hand is to isolate the net impact of the exceptional or extraordinary circumstance. See Order No. 864 at 48-49. Including only the negative portion of the macroeconomic variables chosen by Thress leads to a bias in the estimate. Therefore, it was inappropriate for Thress to include only the segments of time of the Great Recession that are favorable to the Postal Service’s position.

The one exception to this is for the beginning of the Great Recession’s impact on Package Services. The Package Services macroeconomic variable’s impact does not turn negative until 2009. This shows that the Great Recession’s impact on Packages Services mail volume is lagged. It would be inappropriate to include 2008’s positive impact because that would be prior to the beginning of the Great Recession’s lagged impact on Package Services.

To estimate mail volume losses by class of mail, the Commission tallies mail volume losses due to the Great Recession to their fiscal year based on the relevant macroeconomic variables for each class. Once the rate of change of the impact of these variables is no longer negative (*i.e.*, the volume loss dissipates, meaning that the impact of the relevant macroeconomic variable turns positive), the negative effects of the Great Recession as measured by such macroeconomic variables are abating. Since the purpose of the macroeconomic variables is to measure the impact of the economy on mail volume, once it turns positive, it marks a return to economic growth as pertaining to such macroeconomic factor. This marks the end of the volume loss due to

the Great Recession on that class of mail.<sup>63</sup> Since mail volume is, in part, a function of macroeconomic variables, once the impact of the relevant macroeconomic variables turns from negative to positive for an entire class of mail, the impact of those macroeconomic variables is no longer due to the Great Recession.

### c. Curve Fitting Techniques

Thress' econometric practice relies heavily on curve-fitting techniques. This leads to the presence in his demand equations of many terms that are either dummy variables, trends, or intervention variables and trend terms that combine several dummy variables and trends. Such terms are not necessarily inappropriate in a demand equation; however, the usual practice is to include them only when it is clear what they represent. In Thress' demand equations, these terms are often ambiguous in the sense that there is no definitive way to identify the causes for the effects that these variables or trends capture. Below, the Commission discusses Thress' use of the particular curve fitting techniques of (1) the Hodrick-Prescott Filter (HP Filter) and (2) intervention analysis.

*Use of the Hodrick-Prescott Filter.* Many of Thress' equations, such as the equation for Workshared First-Class, are fit to variables that are derived by applying the HP Filter to his chosen measure of economic activity, such as employment. As discussed above, the HP Filter divides a variable into two components: a trend component and a residual usually labeled the cyclical component.<sup>64</sup> This labeling is somewhat misleading since both components typically respond to the business cycle when using macroeconomic variables. The HP Filter is commonly used to remove

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<sup>63</sup> The period of time for recognizing the impact due to the Great Recession is discussed in more detail in section IV.D.2. As discussed in that section, the Postal Service fails to show the losses after this point are due to the Great Recession.

<sup>64</sup> The HP filter isolates the cyclical component from the trend component in the raw time series by solving a minimization problem (a least square problem). The minimization function contains a so called smoothing parameter. The larger the smoothing parameter, the smoother the trend. The HP Filter produces the trend component by suppressing the high-frequency variation in the original series. The cyclical component is everything that has been left out of the trend.

short-term fluctuations that are associated with the business cycle, thereby revealing long-term trends.

Commenters argue that use of the HP Filter could result in misspecification of the demand equation. MPA argues that only the cyclical component should be attributed to the Great Recession while the Public Representative argues that only the trend component should be attributed to the Great Recession. GCA argues that the use of the HP Filter improperly distorts the data.

In response to these arguments, Thress asserts that “[i]n some cases...demand for some products may react differently to temporary, or cyclical, changes to the economy than it does to more permanent trend, changes to the economy.” Response to POIR No. 1, question 9.<sup>65</sup> Additionally, Thress contends that “[o]ne feature of the Great Recession, as distinct from some earlier, lesser recessions, is that, because of the length and magnitude of the Great Recession, it affected not only the cyclical demands for goods and services but it also had a significant impact on long-run macroeconomic trends.” *Id.* Accordingly, Thress, asserts that these changes in long-run trends are to be understood as a result of the Great Recession. *Id.*

Thress’ models demonstrate that the macroeconomic variables or filtered portions of such macroeconomic variables (via a HP Filter) in their respective demand equations have an impact on mail volumes. While the filtered trend components provide a sort of smoothing of real data, the cyclical component rather focuses on business cycle. Both components, however, reflect real data. Ideally, the most useful model for determining the impact of the Great Recession on mail volumes would contain all the variables that explain variation in volume, and the regression coefficients would be statistically significant. Instead, the Postal Service’s econometric model (used as a

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<sup>65</sup> Thress also asserts that several of the cyclical portions of macroeconomic variables were not used because they were not statistically significant at a 95 percent confidence interval. Response to POIR No. 3, question 8; see *also* Thress Reply Statement at A13-14; Postal Service Reply Comments at 39-40.

base for the estimation of mail volume losses due to the Great Recession) is the only model on the record.

If the cyclical portions of the macroeconomic variables are not considered due to the Great Recession, as the Public Representative suggests, then the Commission essentially would be saying that there is no macroeconomic impact of the Great Recession on mail volumes for First-Class Workshared Letters, Cards, and Flats; and Standard Nonprofit Enhanced Carrier Route Mail. If the trend component is not considered due to the Great Recession, as MPA suggests, then the Commission essentially would be saying that there is no macroeconomic impact of the Great Recession on mail volumes for First-Class Single-Piece Letters, Cards, and Flats; and Standard Nonprofit Mail. Both of these results seem implausible as the Great Recession clearly had an impact on the relevant macroeconomic factors. Accordingly, the Commission uses the HP Filtered data as suggested by Thress.

*Use of Intervention Analysis.* Thress uses different intervention variables and trends in his demand equations to attribute mail volume losses to the Great Recession. Thress attributes mail volume losses to the Great Recession for the following intervention variables and trends separated, by grouping of market dominant mail:

**Table IV-4**

**Intervention Variables Used In Demand Equations, by Subclass**

<b>Class</b>	<b>Subclass</b>	<b>Intervention Variable Used In Demand Equation</b>
<b>First Class</b>	Single Piece Letters, Cards, and Flats	Diversion Trend Starting in 2007Q4
<b>First Class</b>	Workshared Letters, Cards, and Flats	Diversion Trend Starting in 2008Q1
<b>Standard</b>	Regular Mail	Non-Linear Intervention Variable Starting in 2008Q2
<b>Standard</b>	Regular Mail	Negative Trend Starting in 2007Q1
<b>Standard</b>	Nonprofit Mail	Non-Linear Intervention Variable Starting in 2009Q2
<b>Standard</b>	Nonprofit Mail	Negative Trend Starting in 2011Q2
<b>Periodicals</b>		Time Trend Starting in 2008Q2
<b>Periodicals</b>		Time Trend Starting in 2011Q2
<b>Package Services</b>	Bound Printed Matter	Non-Linear Intervention Variable Starting in 2008Q3
<b>Package Services</b>	Media and Library Mail	Time Trend Starting in 2010Q2

Thress Statement at Appendix II; Response to POIR No. 3, question 2; Library Reference USPS-R2010-4R/10.

For such intervention analysis, Thress' variables take one of three forms in his demand equations: (1) an initial pulse that attenuates to a long-run plateau; (2) an initial pulse that gradually goes away over time; or (3) a linear time trend. Response to POIR No. 6, question 12.<sup>66</sup>

Thress asserts that volume losses associated with these Intervention variables and trends are attributable to the Great Recession because they begin close in time to the Great Recession. He notes that the decline in mail volume accelerated around 2008 while the growth of internet access as measured by broadband had leveled off by that time. Therefore, he concludes that to the extent that a post-2007 acceleration in electronic diversion occurred, it was caused by the Great Recession because the Great Recession created an incentive to find less costly ways to communicate and conduct transactions. He further supports attributing the volume loss to the Great Recession by claiming that: (1) advertising and investment spending has fallen since 2007; (2) indirect measures of volume, including bills and bill payments (such as real median household income, credit card accounts, loans, mortgages, and new households/home ownership) have fallen since 2007; and (3) mail volume would be larger but for the shortfall between actual total GDP and potential GDP. See Response to POIR No. 1, questions 4, 6; Response to POIR No. 2, question 6; Response to POIR No. 3, questions 1-2; Response to POIR No. 4, questions 2, 6; Response to POIR No. 6,

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<sup>66</sup> Non-linear intervention variables, as a part of the intervention analysis, include a pulse function, and a step function. Thress Statement at II 8. In general, the impacts that are modeled by intervention variables are unusual or singular. Pulse functions are typically employed if the events are expected to be temporary and decay over time. Step functions typically model more prolonged events. See Yaffee R.A., McGee M., Introduction to Time Series and Forecasting: with Applications of SAS and SPSS: Academic Press, 2000 at 265. Thress does not consider all intervention variables that he includes in the demand equations to be Great Recession related, but only those that start coincident with the Great Recession. Response to POIR No. 6, question 1.

questions 4-5, 8, 12, 19, 26; Response to POIR No. 9, questions 2, 7-9, 11; Tr. 1/101-02, 114, 117; *see a/so* NPMHU Comments at 3-5.

Commenters take issue with the Postal Service's contention that its intervention analysis persuasively shows that volume loss that began around the time of the Great Recession and is not directly modeled through macroeconomic variables is attributable to the Great Recession. Commenters assert that changes in mail volume trends that occurred around 2008 were due to adoption of technological innovations as alternatives to mail rather than the Great Recession. See PR Comments at 27-34; FSR and NAMIC Comments at 3-4, 8; MPA Comments at 21-42; NPPC Comments at 12-26; ABM & SIIA Comments at 1; GCA Comments at 10-20; Clifton Statement at 23-28; ABA Comments at 4-5; NPPC Comments on Buc Statement at 2-4; Buc Statement at 19-25; Collins Comments at 3.

Thress does not provide sufficient evidence that the intervention variables and trends he utilizes are attributable to the Great Recession. He concedes that "if the model is missing one or more key factors which were responsible for part or all of that decline in mail volume, the model has no way ... to assign part of that decline to other factors." Response to POIR No. 9, question 7. The intervention variables and trends capture only the net effects of impacts that are not explicitly modeled through other variables or trends. As Thress stated at the hearing, "[a] trend variable is going to pick up anything that trends. It's going to pick up macroeconomic trends, demographic trends, diversion trends. And so it becomes difficult to pull out and say this trend was because of this one specific factor." Tr. 1/90-91. Intervention variables and trends indicate that something happened, they do not attempt to explain why that something happened.

As NPPC points out, intervention variables and trends do not demonstrate a cause and effect relationship between the extraordinary or exceptional event and mail volume. They only demonstrate that the extraordinary or exceptional event happened more or less contemporaneously with the decline in mail volume. While intervention

variables and trends are useful in predicting future mail volumes, they are not very useful in explaining why past mail volumes acted in particular ways. As Thress concedes, “to understand why these [intervention] trends have changed requires moving outside of the econometric models and analyzing the underlying factors that are driving these trends.” Response to POIR No. 3, question 1.<sup>67</sup>

In some circumstances, using intervention variables and trends might be appropriate to measure the impact of an extraordinary or exceptional event. For example, if all non-extraordinary and exceptional events that drive mail volume had positive impacts on mail volume but all extraordinary and exceptional events had larger negative impacts on mail volume, then it would be possible to use intervention variables and trends to explain mail volume declines due to extraordinary or exceptional circumstances. In such a case, the applicable intervention variables or trends would show a negative net impact on mail volume and such impact could be attributed to the extraordinary or exceptional event. Such a measurement would “not exceed the net adverse financial impact of the exigent circumstances.” Order No. 864 at 50-51.

In the current case, intervention variables and trends are problematic because both the extraordinary or exceptional event (the Great Recession) and other, non-extraordinary and exceptional drivers of mail volume (such as technological innovations), are captured by the intervention variables and trends. Both drivers of mail volume move in the same negative direction. Thus, it is not possible to accurately separate what mail volume loss is due to the Great Recession and what mail volume loss is due to other drivers of mail volume such as technological innovations based on those intervention variables and trends.

Thress responds to commenter criticism in this respect by attempting to show that the rate of diversion implied by Lundblad’s and others’ analysis is implausibly large.

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<sup>67</sup> See *also* Tr. 1/113 (“In terms of what caused those diversions, why did the diversions change at that time, that’s a question that requires one to – I’ve said in several responses – I think step outside the econometric model.”)



Thress Reply Statement at 3-35. In doing so, however, Thress assumes that other commenters are arguing that the volume impact attributable to all of the Postal Service's intervention variables and trends are due to electronic and other diversion. That is a mischaracterization of the commenters' arguments in this case. The commenters are stating that the Postal Service did not prove that the intervention variables and trends are due to the Great Recession. It is possible, as stated by Thress in his Reply, that some of the volume losses captured by the intervention variables and trends are due to the Great Recession.<sup>68</sup> However, the Postal Service has not made a compelling showing that all of the volumes losses due to the intervention variables and trends are due to the Great Recession. Additionally, in framing his argument in this manner, Thress improperly attempts to shift the burden in this case. It is not the Postal Service's responsibility to show that other commenters' estimates are implausibly large, rather, it must show its own estimates are accurate.

Order No. 864 emphasizes that the Postal Service need not quantify the adverse impact with absolute precision. Instead, Order No. 864 builds on a proportionality standard suggested by the Postal Service. The Commission found that "[s]upportable methods justifying the quantification must be commensurate with the amount of the proposed adjustment. A larger amount requires more rigorous estimation techniques and a more persuasive showing that the sums sought are the result of the exigent circumstance." *Id.* at 50.

In this case, the Postal Service quantifies the impact of the Great Recession through FY 2014 as \$39.8 billion. An impact of over \$39 billion requires rigorous

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<sup>68</sup> Indeed, volume may be lost to other causes as well. The Postal Service states that "the question is to what extent the Postal Service identifies volume losses due to the Great Recession, and to what extent it effectively identifies volume losses as due to electronic diversion." Postal Service Reply Comments at 27-35. This framing of the question, however, improperly sets up a false dichotomy. The loss of mail volume is not a perfect dichotomy between the cause of electronic diversion and the cause of the Great Recession. The Postal Service needs to factor out the effects of electronic diversion and all the impacts of other, non-extraordinary or exceptional factors that influence mail volume. The remaining amount is what is due to the Great Recession.

estimation techniques. The Postal Service was not able to develop a model that directly identifies volume loss due to the Great Recession. Rather, the Postal Service assumed all of the acceleration in volume loss was due to the Great Recession. See, e.g., Postal Service Reply Comments at 32. Order No. 864 requires a more persuasive showing.

Indeed, notwithstanding the Commission's guidance in Order No. 864, the Postal Service presents a minimally supported assumption to justify its claims of substantial, cumulative losses. On the basis of this assumption it believes that section 3622(d)(1)(E) would allow rate increases to generate \$39.8 billion. Compare this with its most recent annual CPI-based rate increases, which were limited to generating \$0.56 billion. Even though the Postal Service is seeking only a small fraction of the almost \$40 billion it claims at this time, the Postal Service believes it is entitled to more if necessary. Response to POIR No. 5, question 2. Thus, its effort to accurately measure net impact must be viewed against its \$39.8 billion projection. The Postal Service's attempted quantification of the net adverse impact of the Great Recession does not come close to satisfying the Order No. 864 standard for the precision necessary to support that level of impact.

Thress and the Postal Service argue that technological innovations between 2008 and today are not new technologies with new impacts on mail volume, but rather continuations of longer term trends toward usage of the internet. See, e.g., Postal Service Reply Comments at 33-35, 66-68. This argument might be persuasive if the only thing that were changing were the speed of the internet connections (*i.e.*, dial up, DSL, FiOS). Technological inventions released and adopted during the time period in question have fundamentally altered the manner in which the American public communicates. Mobile smart phones and tablets with their numerous "apps" have not just changed the speed of the internet, but they have made it easier to communicate over the internet. Consumers need no longer be tethered to a laptop or desktop to engage in internet-related communications. Additionally, the social media explosion has altered the internet landscape. With these sites, the internet is no longer a network

of webpages, searches and e-mail accounts; it is a place to interact and communicate quickly with friends and customers. In 2010, Facebook surpassed Google for highest total percentage of time spent on the internet. In 2013, comScore found that nearly 40 percent of internet time is now on mobile devices. The post-2007 internet, as used by Americans, looks very different from the pre-2007 internet.

Internet advertising has also significantly changed during the time period in question. The Postal Service contends that the decline in advertising mail volume between FY 2007 and FY 2012 was due in large part to a cumulative decline of approximately 15 percent in total spending on advertising, a decline that the Postal Service attributes to the Great Recession. Response to POIR 3, question 1; Tr. 1/124, 139-144. However, MPA provided evidence showing that total spending on advertising other than direct mail declined by no more than five percent during this period. Swallen Statement at 2-3. Indeed, Swallen believed that his estimate “is likely an overstatement of how much total ad spending has actually declined” based on a limitation in the “tracking and reporting on online advertising.” *Id.* at 2. This is because his measurement is “limited to Internet display ad formats. Other forms of online advertising – paid search, video, mobile, social – are not included.” *Id.* He asserts that “[e]xternal estimates of online ad spending from the Internet Advertising Bureau, which are based on self-reported revenue from media owners, indicate paid search, video, mobile and social are an increasing proportion of total online ad spend and are growing at a faster rate than display.” *Id.* at 3. Thus, MPA asserts, the mail volume decline due to advertising was due to the Postal Service losing advertising market share to the internet gaining in popularity, not the Great Recession. MPA Comments at 38, 42.

MPA effectively refutes the Postal Service’s contention that there was no increase in the rate of diversion due to these new technologies. More likely, as MPA contends, there was “a succession of derivative or complementary innovations, each with its own S-curve” that impacted the rate of mail diversion not due to the Great Recession. MPA Comments at 30-31.

Thress and the Postal Service claim that they have “carefully identified the ‘foreseeable’ and ‘predictable’ portion of volume losses due to electronic diversion, and explicitly excluded those continuing losses from its entirely separate estimate of recession-related volume losses.” Postal Service Reply Comments at 67. The Postal Service’s claim might be based on a misinterpretation of Order No. 864. In that Order, the Commission stated that “[w]hen quantifying the net adverse financial impact of the exigent circumstances, the Postal Service must factor out the financial impact of non-exigent circumstances, such as the continuing effects of electronic diversion.” Order No. 864 at 48. The “continuing effects” of electronic diversion that must be factored out are not only those effects of “foreseeable” or “predictable” electronic diversion but all electronic and other diversion that is not due to the exigent circumstances. Thus, “continuing effects” of electronic diversion could include new electronic diversion that had not been accounted for in prior demand equation trends or variables.

Additionally, the Postal Service’s claim that it has explicitly excluded continuing losses due to diversion from its entirely separate estimate of recession-related volume losses is only true if the rate of electronic diversion (or any diversion of mail) does not change at any point of time from the beginning of the Great Recession through at least the second fiscal quarter of 2011 due to factors other than the Great Recession.<sup>69</sup> Given the rate of adaptation and acceptance of new technological innovations that have occurred in the time period from 2008-2011 (MPA Comments at 30-40; Lundblad Statement at 15-18; GCA Comments at 12-15; Clifton Statement at 24-27; PR Comments at 31-34) which have had a large impact on the way Americans communicate, that assumption is not plausible. This is especially true for the linear intervention trends that Thress attributes to the Great Recession. For example, the linear intervention trend that begins for Periodicals in 2011, two years after the official

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<sup>69</sup> Thress attributes to the Great Recession two intervention variables or trends to Periodicals and Nonprofit Enhanced Carrier Route Mail beginning in the second quarter of FY 2011. See Library Reference USPS-R2010-4R/10.

end date of the Great Recession, shows that the pace of diversion for Periodicals mail increased at the time. This increase in the rate of diversion, according to Thress' models is expected to go on forever. It seems plausible, however, that such a trend is due to the impact of e-readers and tablets, which rose to popularity around that time, rather than the Great Recession. MPA Comments at 32; Lundblad Statement at 15-17; GCA Comments at 12-14; Clifton Statement at 24-26; PR Comments at 31.

The Postal Service and Thress argue that changes to long-term trends and even changes to the rate of electronic diversion that may have occurred during the time period surrounding the Great Recession should be treated as attributable to the Great Recession. See *e.g.*, Postal Service Reply Comments at 27-32. There is nothing before the Commission that suggests changes in long run trends or changes in the rate of electronic diversion are due to the Great Recession. As MPA notes, business strategies to replace mail with electronic communications typically require large upfront costs which may not be readily available during recessions. Plans to make these types of investments would have likely occurred prior to businesses' knowledge of the Great Recession.<sup>70</sup> Changes of this regard should not be considered part of the volume losses due to the Great Recession and need to be properly factored out of Thress' analysis.

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<sup>70</sup> Buc's surveys and interviews support this finding, Buc Statement at 4, 19-25, although they are by no means a statistically reliable sample. Postal Service Reply Comments at 68-70.

Thress' linear intervention trends all suffer from that same fundamental problem; they are not cyclical.<sup>71</sup> As MPA points out, the Great Recession is a cyclical event. The Great Recession is part of a business cycle, albeit one with much more severe consequences and impacts than most other recessions.<sup>72</sup> Accordingly, it does not make sense to include Thress' linear intervention trends as part of the Commission's methodology for measuring the impact of the Great Recession on mail volumes. See MPA Comments at 27-28. Long-term trends of this nature are due to factors other than the Great Recession. Therefore, volume loss estimates by these trends should not be attributed to the Great Recession.<sup>73</sup>

The remaining mail volume losses that the Postal Service proposes the Commission attribute to the Great Recession are associated with non-linear intervention variables.<sup>74</sup> All but one of these non-linear intervention variables exhibit characteristics

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<sup>71</sup> Linear intervention trends differ from the trend component of a macroeconomic variable that has been put through an HP Filter, even though both use the word "trend." Linear intervention trends go on forever in the same direction as they started. The linear intervention trends that Thress attributes to the Great Recession continue in a negative direction forever. The trend component of a macroeconomic variable that has been put through an HP Filter is somewhat of a misnomer. It does not capture a pure trend. It is based on the values of the macroeconomic variable and moves according to the values of that variable. Thus, it does not go on forever in the same direction as a linear intervention trend does; rather it rises and falls based on the underlying macroeconomic data. As soon as it begins to rise (due to an improvement in macroeconomic conditions), the Commission's methodology, as discussed above, no longer attributes those positive changes to the Great Recession. In essence, Thress' linear intervention trends go on forever in a negative direction while the trend components of macroeconomic variables do not.

<sup>72</sup> According to NBER, the American economy has been in the economic expansion part of a business cycle since June 2009. See Business Cycle Dating Committee Report, National Bureau of Economic Research, September 20, 2010 ("the committee determined that a trough in business activity occurred in the U.S. economy in June 2009. The trough marks the end of the recession that began in December 2007 and the beginning of an expansion.").

<sup>73</sup> Because the Commission is not attributing the linear intervention trend for First-Class Single-Piece Mail to the Great Recession, it need not reach the issue raised by GCA and Clifton as to whether this trend actually exists.

<sup>74</sup> The Public Representative suggests only attributing the initial "shock" or "pulse" of these intervention variables to the Great Recession. However, as the Postal Service and Thress pointed out on reply, the Public Representative made an error in his attempts to do so. In any event, this suggestion does not present a workable solution because it would not produce a variable that has a viable fit for the econometric models. See, e.g., Postal Service Reply Comments at 38-39.

of cyclical variables and shift to a positive impact on mail volumes that coincides with the point in time that the macroeconomic variables used by the Postal Service in their corresponding demand equations begin to improve. The one exception is the non-linear intervention variable associated with mail from the Package Services class.

As previously discussed, no econometric model that separates mail volume loss due to the Great Recession from mail volume loss due to electronic diversion has been provided on this record. In the absence of such a model, on this record, it is appropriate to attribute mail volume losses associated with these non-linear intervention variables to the Great Recession, with the exception of the non-linear intervention variable associated with Package Services. It is appropriate to attribute volume losses associated with these non-linear intervention variables because these variables shift at the same point in time as their corresponding macroeconomic variables. Thus, it is more likely than not that these non-linear intervention variables are capturing macroeconomic behavior. Mail volume losses associated with these variables are properly attributable to the Great Recession until such time as the “new normal” comes into existence. See section IV.D.2, *supra*.

The non-linear intervention variable associated with Package Services does not exhibit these same characteristics. It moves independently from the macroeconomic variable and thus cannot be considered related to that factor. As a result, the Commission cannot conclude, on this record, that mail volume losses determined based on that non-linear intervention variable are attributable to the Great Recession. Accordingly, volume loss estimates by the Package Services non-linear intervention variable should not be attributed to the Great Recession.

## 2. Period of Time for Recognizing Impact due to the Great Recession

There is no commenter disagreement as to when the Great Recession began. According to the National Bureau of Economic Research (NBER), the Great Recession officially began in December 2007 and ended in June 2009, lasting approximately

18 months. Although Thress suggests that certain macroeconomic variables indicate that the impact on Postal Service mail volumes began prior to FY 2008, see Thress Statement at 6, he asserts that the Postal Service is contending that the start date for measuring the impact of the Great Recession on mail volumes should be in FY 2008 PQ1. Response to POIR No. 6, question 6; see *a/so* Tr. 1/110.

Measuring the end of the impact of the Great Recession, however, is a subject of considerable disagreement. The Postal Service does not foresee an end date for the impact “due to” the Great Recession.<sup>75</sup> The Postal Service contends that the impact continues indefinitely. See, *e.g.*, Postal Service Reply Comments at 50-55. Thress suggests that it could last 20 years or more. Tr. 1/103-04. GCA argues that any volume losses occurring after the Great Recession’s official end date are ineligible for recovery because they were “caused by contemporaneous macroeconomic drivers, not by those which prevailed during the [Great R]ecession itself.” GCA Comments at 7. GCA further asserts that “adverse impacts remote in time from an exigent circumstance could be the result of non-exigent supervening causes.” *Id.* at 8. Similarly, NPPC argues that any losses after the end date of the Great Recession were losses during the recovery, not during the Great Recession. NPPC Comments at 10-12.

Based on statements made by Thress, the Public Representative asserts that the impact of the Great Recession would have ended once there was a “new normal.” PR Comments at 24-25. This “new normal” may have begun, according to the Public Representative, by calendar year 2010.<sup>76</sup> *Id.* MPA asserts, based on a risk exposure analysis, that the impact of the Great Recession bottomed out in FY 2009 and FY 2010. MPA Comments at 19-23, Lundblad Statement at 32-37. MPA contends that this risk

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<sup>75</sup> As part of its Request in this case, the Postal Service states that it is only seeking to attribute 53.5 billion pieces of volume loss in FY 2012. It leaves open the possibility that it may request additional funding attributable to volume losses in other years. See Response to POIR No. 5, question 2.

<sup>76</sup> NPPC uses a different definition of “new normal.” NPPC et al. Comments at 5. NPPC asserts that the new normal emerged from changes in technological developments in communications, rather than the more widely accepted definition of a new economic reality in the aftermath of the Great Recession.



analysis also shows that the Postal Service effectively recovered by FY 2012. *Id.*<sup>77</sup> Valpak asserts that the Postal Service should not be allowed to recover for losses more than one year outside of the official NBER end date of the Great Recession, effectively, mid-2010. Valpak Comments at 26-27, 44, 77. The Postal Service asserts that “it is necessary to extend the analysis to include whatever time periods in which that *impact* continues for specific categories of mail.” Postal Service Reply Comments at 36-37 (emphasis in original). Under its proposal, the Postal Service seeks to recover \$1.78 billion in lost contribution annually, while holding out the possibility of seeking up to an additional \$20 billion (as of FY 2012 and growing) at some point in the future.<sup>78</sup> The Commission agrees with the Public Representative and others that at some point there is a new economic normal that effectively ends the impact of the Great Recession on the Postal Service. At that point, any continuing volume losses are no longer due to the Great Recession, but rather are due to the interplay of other factors. To conclude otherwise would ignore the fact that section 3622(d)(1)(E) is an exception to the price cap, section 3622(d)(1)(A). As the Commission found in Order No. 864, “[t]he exigency provision provides an exception to that general rule. As an exception, the exigency provision should not be interpreted to ‘swallow the rule.’” Order No. 864 at 36.

Essentially, the Postal Service suggests that it should be allowed to recover amounts purportedly due to accelerating volume losses that began during the Great Recession. It fails to show volume losses of that magnitude are due to that recession. Effectively, allowing recovery in the manner that the Postal Service suggests could result in a system where the price cap provision was irrelevant because and the exception will have “swallow[ed] the rule.” *Id.* Such a result would be improper and go against the purposes of the statutory scheme. Similarly, only allowing recovery for losses during the official dates of the Great Recession would deny the possibility that

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<sup>77</sup> MPA asserts that the Postal Service needs to adapt to the new economic normal by the end of FY 2016. MPA et al. Comments at 10, 57.

<sup>78</sup> Postal Service Reply Comments at file: “Cumulative.v.Annual.Impact.xlsx.”

the effects of the extraordinary or exceptional circumstances continue beyond a strictly technical reading of when the Great Recession ended.

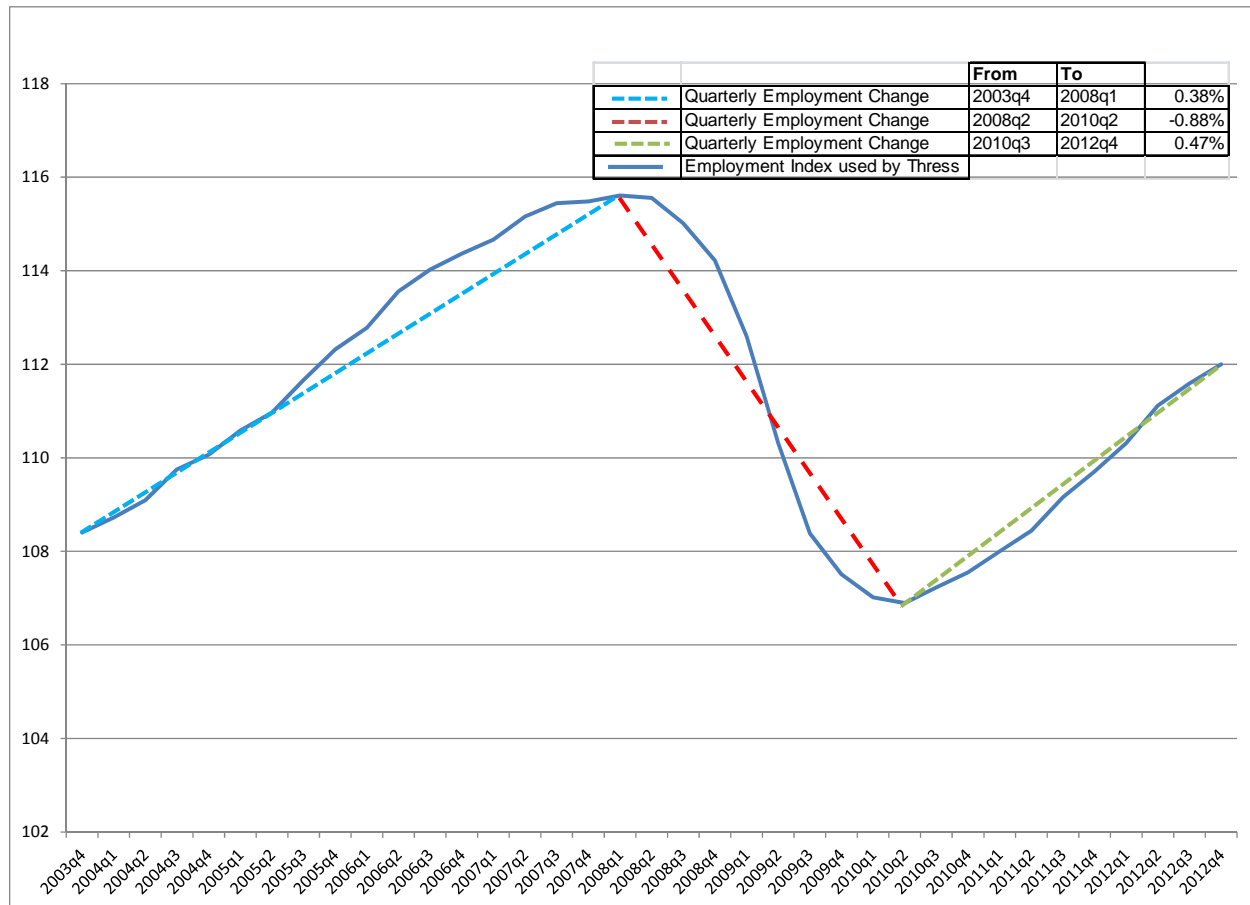
No commenter has suggested a test for determining when the new normal has arrived. For the Great Recession, the Commission concludes that the “new normal” point in time is when all or most of the following occur: (1) the disruption to a sufficient number of relevant macroeconomic indicators demonstrate a return to near historic positive trends; (2) application of the macroeconomic variables accurately project change, and the rate of change on Postal Service mail volumes is positive; (3) the Postal Service regains its ability to predict or project mail volumes following an extraordinary or exceptional event; and (4) the Postal Service demonstrates an ability to adjust operations to the lower volumes. As Thress suggests, the new normal may be different for each class of mail. Tr. 1/116, 119.

*Macroeconomic Variables as Indicators of the New Normal.* Employment is a major macroeconomic indicator that is useful in determining when the new normal began.<sup>79</sup> As shown in the graph below, the quarterly rate of change for total private employment in the United States prior to the Great Recession was at 0.38 percent, during the Great Recession the quarterly rate of change for employment was at negative 0.88 percent, after June 2009 it went back to up to 0.47 percent. This shift from negative to positive for this rate of change occurred in the second quarter of 2010. Thus, according to this macroeconomic indicator, the new normal began around the second quarter of 2010.

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<sup>79</sup> This is especially true since employment is used as a macroeconomic variable in several of the Postal Service’s demand equations.

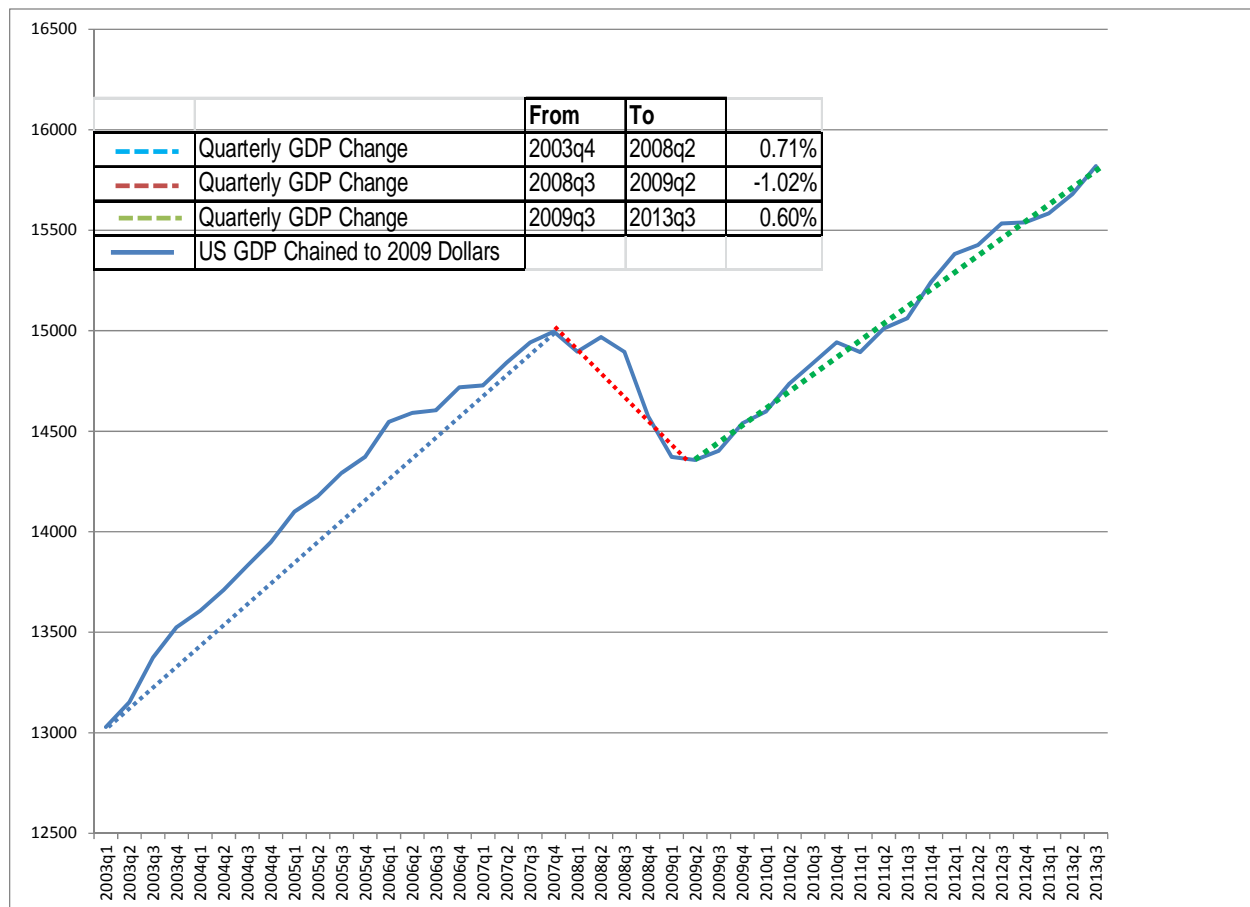
**Figure VI-2**  
**US Employment Index**



GDP is another important macroeconomic indicator that is useful in determining when the new normal began. NBER uses GDP in determining periods of economic recession and expansion. As shown in the graph below, the rate of change for Chained GDP prior to the Great Recession was at 0.71 percent per quarter, during the Great Recession the rate of change for GDP was at negative 1.02 percent per quarter, after the Great Recession it has gone back to up to .60 percent per quarter. The shift from negative to positive for this rate of change occurred in the second quarter of 2009.

Thus, according to this macroeconomic indicator, the new normal began around the second quarter of 2009.

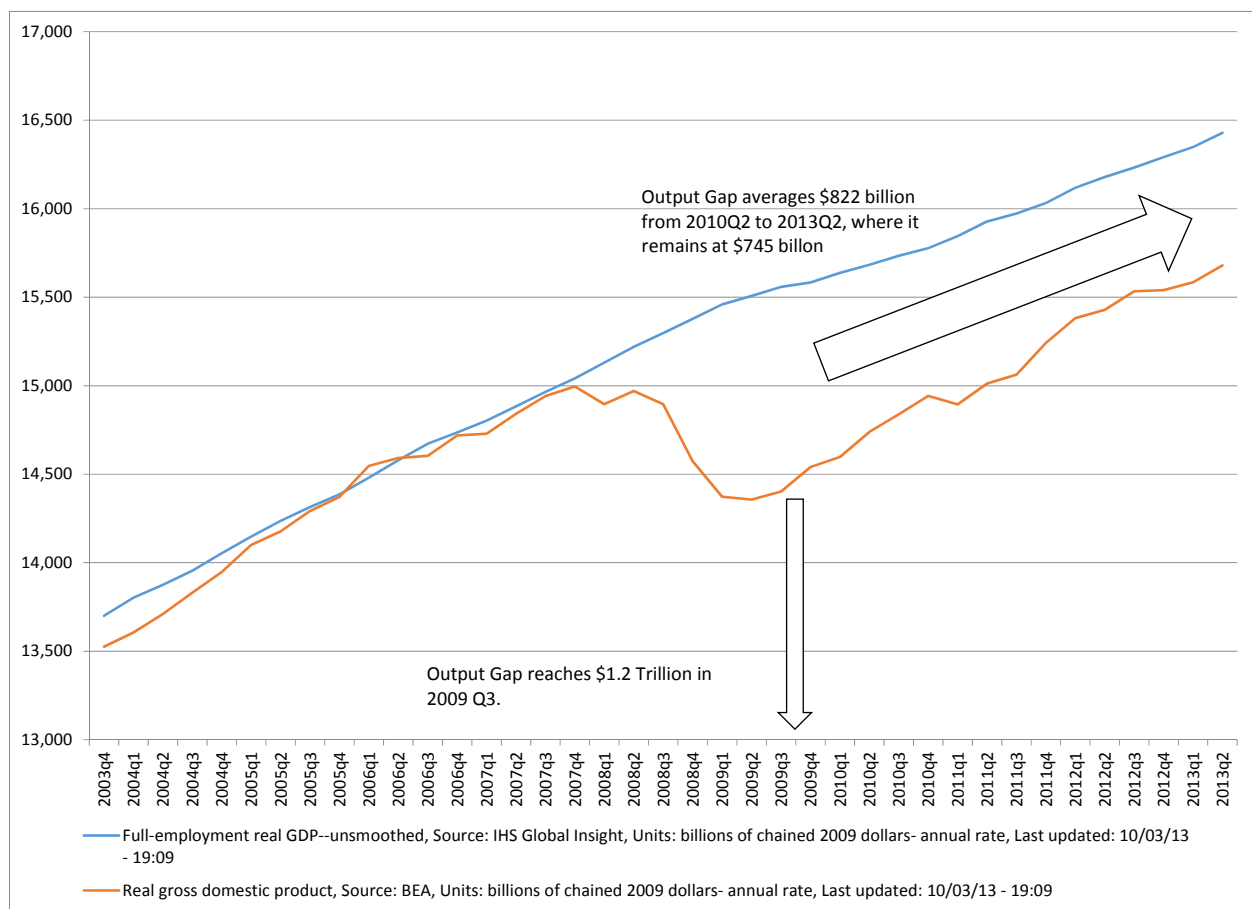
**Figure VI-3**  
**USA GDP 2003-2013**  
**Chained to 2009 Dollars**



As a related matter, Thress discusses an “output gap” that came into existence around the time of the Great Recession between actual GDP and potential GDP. Response to POIR No.1, question 6. The continued existence of this output gap is further macroeconomic evidence of a new normal. Historically, in the long-run actual GDP has tended to fluctuate around the same level as potential (or full employment)

GDP. Since the Great Recession, however, this is no longer the case. *Id.* Actual GDP has remained roughly \$800 billion below potential GDP. The stability of this relationship may be evidence of a new normal. Other economies, such as Japan, have also experienced such long term shifts.<sup>80</sup>

**Figure IV-4**  
**Potential GDP Output Gap 2003Q4-2013Q2**



<sup>80</sup> Japan's GDP output gap was an average of negative 1.2 percent from 1998 through 2006. See <http://world-economic-outlook.findthedata.org/I/2797/Japan>. For a more detailed discussion of the Japan's output gap, see International Monetary Fund, Monetary Policy and the Lost Decade: Lessons from Japan, October 2009, at 4.

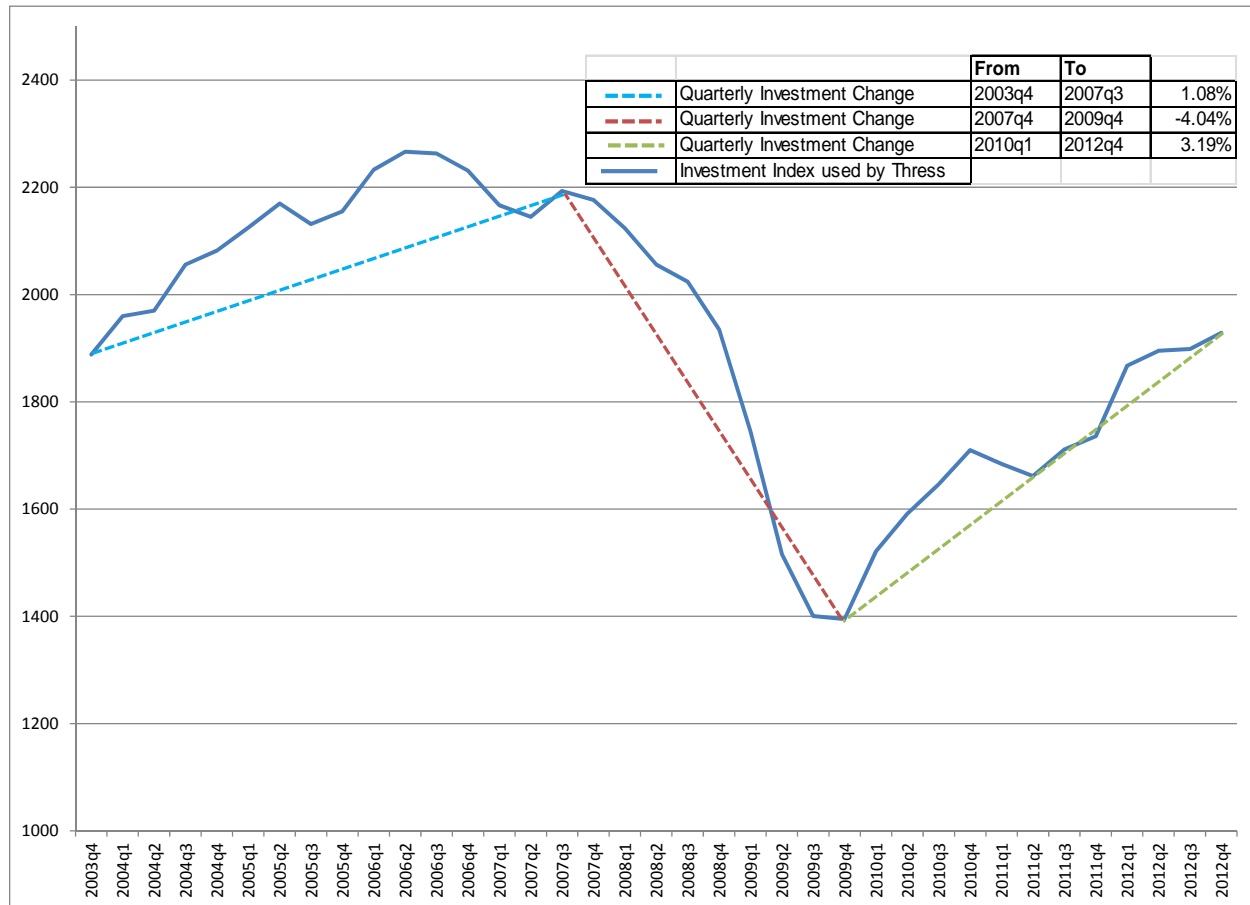
Private Investment is another major macroeconomic indicator that is useful in determining when the new normal began.<sup>81</sup> As shown in the graph below, the quarterly rate of change for total investment in the United States prior to the Great Recession was at 1.08 percent, during the Great Recession the quarterly rate of change for investment was at negative 4.04 percent, after Quarter 4 of 2009 it went back to up to 3.19 percent. The shift from negative to positive for this rate of change occurred in the first quarter of 2010. Thus, according to this macroeconomic indicator, the new normal began around the first quarter of 2010.

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<sup>81</sup> This is especially true since investment is used as a macroeconomic variable in several of the Postal Service's demand functions.

Figure IV-5

## US Investment Index

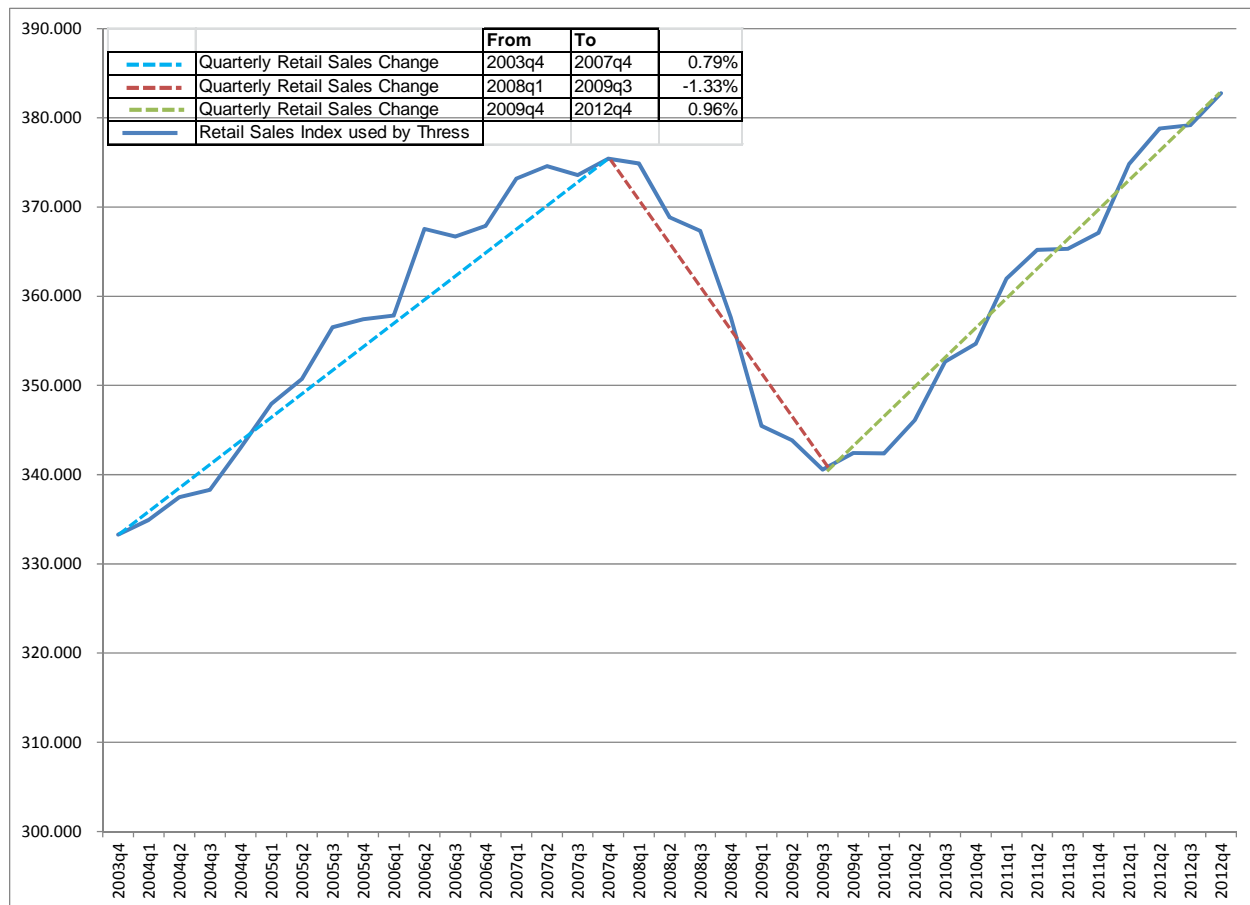


Retail Sales is also a major macroeconomic indicator that is useful in determining when the new normal began.<sup>82</sup> As shown in the graph below, the quarterly rate of change for total retail sales in the United States prior to the Great Recession was at 0.79 percent, during the Great Recession the quarterly rate of change for investment was at negative 1.33 percent, and after Quarter 3 of 2009 it went back to up to 0.96 percent. The shift from negative to positive for this rate of change occurred in the

<sup>82</sup> This is especially true since retail sales is used as a macroeconomic variable in several of the Postal Service's demand functions.

fourth quarter of 2009. Thus, according to this macroeconomic indicator, the new normal began around the fourth quarter of 2009.

**Figure IV-6**  
**US Retail Sales Index**



Additionally, Lundblad's mean risk exposure analysis based on real GDP, nonfarm payroll, real retail sales, and real private domestic investment show that the effects of the Great Recession bottomed out in FY 2009 and FY 2010. MPA Comments at 19-21.

*Macroeconomic variables.* The Commission also has evaluated how the change in applicable macroeconomic variables used in Thress' demand model influence Postal Service mail volumes. Specifically, the Commission has evaluated when the influence



of macroeconomic variables on mail volume changes from negative to positive. This differs for each class of mail. For First-Class Mail, this occurs between 2010 and 2011. For Standard Mail, this occurs between 2009 and 2010. This interpretation of the data is consistent with Thress' statements at the hearing: "[a]nd so to some extent I think it's fair to call maybe 2010 through 2013 the new normal for standard mail." Tr. 1/119. For Periodicals, the shift from negative to positive occurs between 2011 and 2012. For Package Services, this shift from negative to positive occurs between 2009 and 2010. Thus, as applied to the Postal Service, the applicable macroeconomic variables and appropriate intervention variables indicate that the new normal began for each of the classes of mail between 2009 and 2011.

*Ability of Postal Service to predict its volumes.* Thress discussed the Postal Service's inability to predict mail volumes around the time period of the Great Recession during the hearing. He states:

I would say from my perspective as an econometrician and a forecaster, I feel like we've reached a new normal when -- to some extent when the forecasts start working again. I mean, when we made a forecast in 2008 and 2009, they were terrible, terrible forecasts. You know, we completely missed the boat on how much mail volume was going to be lost. Now, 2011, '12, '13, we're back to a world similar to where we were before in terms of we have a better handle on our forecast. Errors have fallen relatively more in line. That said, one feature of the new normal in respect to that, however -- and I think I mentioned it earlier -- is that standard mail volume has become somewhat less predictable....

Tr. 1/119-20.

Thus, according to Thress' statements from the hearing, the Postal Service has been able to predict mail volume in line with what it was able to do in the past. From this perspective, the new normal occurred between 2010 and 2011.

*Ability of the Postal Service to Adjust.* The Postal Service's ability to adjust its operations to react to lower mail volumes has a bearing on when the new normal occurs. The underlying rationale for this relationship is that if the Postal Service is adjusting to the circumstances, then the circumstances are in the realm of predictability and thus, more normal than extraordinary or exceptional. Once impact of a circumstance is normal, and the Postal Service has begun to adjust to it, additional impact cannot be said to be due to a past extraordinary or exceptional circumstance. A good measure of the Postal Service's ability to adjust to changing circumstances is Total Factor Productivity (TFP). As the Postal Service stated in its reply comments, TFP has been increasing despite the loss in volume. TFP increased by 1.9 percent in FY 2013. Postal Service Reply Comments at 93; Postal Service FY 2013 Form 10-K at 44. This was the fourth consecutive year of positive TFP growth. *Id.* This suggests that the new normal began in 2010, when TFP growth turned positive.

*Conclusion.* Taken together, these four metrics are used by the Commission to determine when a new normal occurred for the Postal Service as a result of the Great Recession. Specifically, it had arrived by the beginning of FY 2011 for First-Class Mail. For Standard Mail, it had arrived by the beginning of FY 2010. For Package Services, it had arrived by the beginning of FY 2010. For Periodicals, the new normal occurred slightly later, it had arrived by the beginning of FY 2012.

### 3. The Cumulative Impact on the Postal Service

The Postal Service estimates that it has lost 53.5 billion pieces in FY 2012 alone due to the Great Recession. Request at 10. According to the Postal Service, losses in a given year "can be volume that is lost for the first time in that year, or volume that was first lost in a previous year, but continues to be lost in the subsequent year." Response to POIR No. 6, question 16. Thus, the Postal Service's estimates its losses for FY 2012 alone to include volume lost in FY 2008, FY 2009, FY 2010, and FY 2011 that continue to be lost as a result of the Great Recession. *Id.* Cumulatively for FY 2008 through FY

2012, including losses continued to be lost from a previous year continuing into a subsequent year, the Postal Service estimates it has lost approximately 189.7 billion pieces due to the Great Recession. *Id.* Using this same methodology, the Postal Service's estimates for lost mail volume in FY 2013 (alone) and FY 2014 (alone) due to the Great Recession increase even more, although at a slower rate, to 58.8 billion pieces and 63.9 billion pieces, respectively. Response to POIR No. 6, question 14.<sup>83</sup>

The Public Representative takes issue with this approach and is concerned that the Postal Service "does not present an estimate of total losses due to" the Great Recession. PR Comments at 16-17. Valpak agrees that the Postal Service's methodology in this respect is problematic. Valpak Comments – Errata at 1-2.

The Commission's responsibility in this case entails determining the Postal Service's total mail volume loss due to the Great Recession. Thus, the Commission must decide how many times it is appropriate to count volume lost in a prior year due to the Great Recession that continues to be lost in subsequent years. Put another way, in calculating the volume losses due to the Great Recession, the Commission must determine whether to count pieces lost once, as lost again every year until volumes rebound. The Postal Service's argument is essentially that volume lost due to the Great Recession in any given year remains lost due to the Great Recession in later years. Thus, it contends, the Postal Service should be able to recover for those losses not just in the year that the loss occurred, but in subsequent years as that piece continues to be lost, because the initial cause of that loss is the Great Recession.

First, this approach makes it impossible for the Commission to fulfill its statutory mandate to calculate the total amount lost due to the exigent circumstance, the Great Recession. According to the Postal Service's argument, if a piece is lost in 2009 due to the Great Recession, it remains lost due to the Great Recession in 2020. And, it should

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<sup>83</sup> NPPC estimates that the net present value of the amount that the Postal Service claims is due to the Great Recession in 2012 alone exceeds \$235 billion. NPPC Reply Comments at 3.

be able to recover for that 2009 piece, annually, through 2020. Such an interpretation of losses would provide billions of dollars of annual “losses” subject to exigent requests whenever the Postal Service could show a “need” for additional funds. As NPPC points out, it would impermissibly allow the Postal Service to “use the exigency provision to circumvent the price cap indefinitely.” NPPC Comments at 4-8; NPPC Reply Comments at 2-3.

Second, once a piece of mail is lost in a given year due to the Great Recession, in subsequent years, the Postal Service is aware of that loss and adjusts its expectations to continue without that mail piece. The Postal Service seeks to recover annually the contribution it would have received from mail long after that mail left the system and after it could have (and has) right-sized operations to reflect the new normal. To find otherwise would improperly discourage the Postal Service from taking necessary steps to right-size its network due to an extraordinary or exceptional event. Essentially, by allowing the Postal Service to recover a continuing and growing stream of “lost contribution” as due to the Great Recession, the Commission would provide the Postal Service with a revenue stream that does not require it to adjust for those lost pieces. *Cf.* PR Comments at 9-10 (suggesting that “the Postal Service has outlined the basis for a ‘cost of service’ price increase.”).

The Commission concludes that volume is lost once. It is now widely accepted that mail volumes will never again achieve 2006 levels. The record in this case indicates that although the Great Recession accelerated that volume decline, the Great Recession cannot be found to have caused that inevitable long-term continuing downward volume trend.

#### 4. Economic Baseline for Measurement

The Postal Service asserts that the baseline for measuring the impact of the Great Recession on mail volumes should be “to a baseline that assumes zero macro-economic growth.” Response to POIR No. 3, question 6. Several commenters

argue that this approach does not properly separate the exigent impact from the expected impact. Valpak argues that the Postal Service's approach is improper because it has chosen a "supremely optimistic" and "purely hypothetical" scenario from which to estimate volume losses due to the Great Recession. Valpak Comments at 42-46. Valpak asserts that the baseline for measuring the impact of the Great Recession should be from an average of the immediately preceding several recessions rather than an "economic nirvana" that would have continued, unabated through 2012. *Id.* at 46-48. Therefore, Valpak contends that the amount that the Postal Service should be entitled to as a result of the Great Recession should not be greater than the difference between the volume the Postal Service would have been expected to lose as a result of a typical recession and the amount it actually lost. *Id.* at 47.<sup>84</sup>

The Public Representative argues that the baseline should take into account how the Postal Service has reacted to the volume loss in terms of shedding mail capacity "to adjust to the new normal." PR Comments at 17-18. As a corollary to this argument, the Public Representative asserts that the Postal Service must quantify the additional contribution it needs to adjust its network to the new economic normal, and should be eligible to recover such an amount. *Id.*<sup>85</sup>

The Public Representative's argument appears to be based on a misunderstanding of the Commission's findings in Order No. 864. In that order, the Commission found that the Postal Service was eligible to recover "the lost contribution associated with the volume declines from the 2008-2009 recession." This means that if the Postal Service can quantify its volume losses attributable to the Great Recession, it can recover the equivalent of its lost contribution through rate increases. This is an

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<sup>84</sup> Valpak argues that the Commission should not allow the Postal Service to recover for more than its actual volume losses. See, e.g., *id.* at 44.

<sup>85</sup> Additionally, the Public Representative contends that the Postal Service should be able to recover the temporary cost of sustaining the postal network while such a network adjustment occurs. PR Comments at 20-22.

independent inquiry from the amount of volume actually lost.<sup>86</sup> Quantification of such volume losses is independent of how the Postal Service has reacted to the volume loss in terms of shedding mail capacity or how it should adjust its network to the new normal, although those factors might be relevant to the “necessary” analysis.

Valpak is essentially asking the Commission to find that only the difference in impact between the Great Recession and an average recession should be considered recoverable in this proceeding. For this argument to be workable, the Commission must determine and model the average recession and the average recession’s impact on the Postal Service.

As a practical matter, it would be difficult to construct a model of an average recession and its impact on the Postal Service. There is no normal or average recession. Each recession has different impacts and affects different sectors of the economy differently. For example, the 2001 recession was predicated on the dot-com bubble while the 1990-1991 recession was predicated on the Savings and Loan Crisis. Additionally, the 2001 recession was mild<sup>87</sup> (GDP decline of 0.3 percent) compared with the 1990-1991 recession (GDP decline of 1.4 percent). The 1981-1982 recession saw a decline in GDP of 2.7 percent. Unemployment peaked at 10.8 percent, 7.8 percent, and 6.8 percent for the 1981-1982 recession, the 1990-1991 recession, and the 2001 recession, respectively. Valpak does not offer a suggestion for incorporating these different macroeconomic figures or other relevant recession-based statistics (macro or postal specific) into a workable model to construct an average recession to compare to the Great Recession for purposes of measuring its impact on Postal Service mail volumes. Therefore, for practical considerations, the Commission finds that the impact of the Great Recession on mail volumes is extraordinary and exceptional; not just the

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<sup>86</sup> The total volume actually lost may be less than the amount lost due to the Great Recession. Other factors, such as population, may have positively offset losses due to the Great Recession such that actual losses are less than losses due to the Great Recession.

<sup>87</sup> Some economists do not even consider the 2001 recession to be a true recession since there was not a fall of real GDP for two consecutive quarters.

difference between a normal recession and the Great Recession. The Commission will measure the impact of the Great Recession on Postal Service mail volumes in this proceeding using a baseline of zero economic growth.

5. Commission Estimate of Total Impact of the Great Recession on Mail Volume

To begin, the Commission uses the only econometric model provided on the record in this proceeding as a starting point for its estimate of the mail volume loss “due to” the extraordinary and exceptional circumstance. This Commission discussed this model in more detail in section IV.B.

The Commission uses the same variables and trends used by Thress in his model to determine mail volume. The Commission’s analysis differs from that of Thress only in the respect of identifying the mail volume losses that are due to the Great Recession. Thress identifies mail volume losses associated with certain: (1) macroeconomic variables; (2) linear intervention trends; and (3) non-linear intervention variables as attributable to the Great Recession on an equation-by-equation basis. As discussed in more detail in section IV.D.1.b., the Commission accepts Thress’ approach for all of his macroeconomic variables – Employment, Investment, Retail Sales, and Foreign Trade. The Commission determines that volume losses associated with these variables are due to the Great Recession because they are directly impacted by macroeconomic activity directly related to the Great Recession. Accordingly, the Commission attributes mail volume losses associated with these macroeconomic variables to the Great Recession in all of Thress’ demand equations.<sup>88</sup>

As discussed in section IV.D.1.b., in calculating the impact of macroeconomic variables for each subclass of mail the Commission includes both the positive and

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<sup>88</sup> Thress provides the impacts of these variables on mail volumes in columns D through G of the file “ExigentImpact.xlsx,” tab: “Volumes,” Library Reference USPS-R2010-4R-10.

negative impacts.<sup>89</sup> However, as discussed in section IV.D.2., once the new normal begins any macroeconomic impacts (or other impacts) on mail volume are no longer due to the Great Recession. The time point indicating the beginning of this new normal is different for each class of mail. Specifically, the new normal arrived by the beginning of FY 2011 for First-Class Mail. For Standard Mail, it had arrived by the beginning of FY 2010. For Package Services, it had arrived by the beginning of FY 2010. For Periodicals, the new normal arrived by the beginning of FY 2012. As discussed in more detail in section IV.D.1.c., the Commission does not accept Thress' approach for attributing volume losses associated with linear intervention trends to the Great Recession. The Commission determines that the Postal Service did not meet its burden of proof in demonstrating that the volume losses associated with these linear intervention trends were due to the Great Recession as opposed to other factors such as new technologies related to the internet. Accordingly, the Commission does not attribute any mail volume losses associated with these linear intervention trends to the Great Recession.<sup>90</sup>

As discussed in more detail in section IV.D.1.c., the Commission accepts all but one of Thress' proposals for attributing volume losses associated with non-linear intervention variables to the Great Recession. The exception to this is for the non-linear intervention variable associated with the Package Services Class.<sup>91</sup> The Commission determines that the volume losses associated with these non-linear intervention variables were due to the Great Recession because they exhibited characteristics similar to those of the relevant macroeconomic variables and likely were capturing

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<sup>89</sup> The one exception being the 2008 positive impact in Package Service which, as discussed in section IV.D.1.b, reflects the Great Recession's lagged effect on that class of mail.

<sup>90</sup> This is column W from the file "ExigentImpact.xlsx," tab: "Volumes," from Library Reference USPS-R2010-4R-10.

<sup>91</sup> The Commission found that this non-linear intervention variable did not exhibit properties of the relevant macroeconomic variables. Therefore, the Postal Service did not meet its burden of proof in showing that mail volume losses associated with this non-linear intervention variable were due to the Great Recession. Accordingly, the Commission does not attribute mail volume losses associated with this non-linear intervention variable to the Great Recession.



macroeconomic activity. Accordingly, the Commission attributes all mail volume losses associated with these non-linear intervention variables to the Great Recession.<sup>92</sup>

The table below presents the Commission's findings with respect to the impacts of the Great Recession on mail volumes as demonstrated by the facts of this case. The mail losses in each column indicate the effect of recession-related factors on mail volumes for the particular class of mail in a given year and the total impact is in the last column. Cells with a zero indicate no impact on mail volumes due to the Great Recession. The Commission finds the Great Recession caused a total volume loss of 25.3 billion pieces.

**Table VI-5**

**Commission Estimates Year-over-Year Changes  
in Mail Volumes due to the Great Recession  
(Market Dominant Mail only in Millions of Pieces<sup>93</sup>)**

	<u>FY2008</u>	<u>FY2009</u>	<u>FY2010</u>	<u>FY2011</u>	<u>FY2012</u>	<u>FY2008-FY2012</u>
First-Class Mail	(582.7)	(1,863.9)	(1,043.3)	0.0	0.0	(3,490.0)
Standard Mail	(5,350.0)	(15,572.0)	0.0	0.0	0.0	(20,922.0)
Periodicals Mail	(110.3)	(377.2)	(352.3)	(15.8)	0.0	(855.5)
Package Services	0.0	(3.4)	0.0	0.0	0.0	(3.4)
<b>TOTAL MARKET-DOMINANT MAIL</b>	<b>(6,043.0)</b>	<b>(17,816.5)</b>	<b>(1,395.6)</b>	<b>(15.8)</b>	<b>0.0</b>	<b>(25,270.8)</b>

**6. Conversion of Total Impact of the Great Recession on Mail Volume Losses to Total Lost Contribution**

In Order No. 864, the Commission provided a framework for estimating the financial impact due to an extraordinary or exceptional circumstance. Specifically, the Postal Service is required to demonstrate that “the amount of the proposed adjustment

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<sup>92</sup> This is column V from the file “ExigentImpact.xlsx,” tab: “Volumes,” from Library Reference USPS-R2010-4R-10.

<sup>93</sup> First-Class Mail includes First-Class domestic mail and First-Class International Letters, Cards and Flats. The Commission's calculations of volume losses due to the Great Recession are provided in the PRC-LR-R2013-11/1.

does not exceed the net adverse financial impact.”<sup>94</sup> In this section, the Commission considers the arguments relating to the proper methodology for converting the volume losses calculated above into total lost contribution eligible for recovery through rate increases.<sup>95</sup> The Postal Service and MPA use the same methodology. The Public Representative suggests a different methodology.

*Postal Service methodology.* The Postal Service proposes to comply with Order No. 864 by quantifying the contribution value of the volume losses it attributes due to the Great Recession. Witness Nickerson provides these calculations.<sup>96</sup> Nickerson aggregates the volume lost in each year from FY 2008 through FY 2012. He then multiplies the total volume lost by the per piece contribution for that category to obtain the contribution loss for each category of mail.<sup>97</sup> The following table provides an example of Nickerson’s methodology and results for FY 2012.<sup>98</sup> Detail is provided for First-Class Mail to highlight the level of detail provided in witness Nickerson’s calculations.

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<sup>94</sup> Order No. 864 at 4.

<sup>95</sup> As discussed in Chapters V and VI, below, the rate adjustments based on these amounts must still meet the “reasonable and equitable and necessary” requirements of 39 U.S.C. 3622(d)(1)(E).

<sup>96</sup> See USPS-LR-R2010-4R/11 (revised October 25, 2013) at 1.

<sup>97</sup> See *also* Postal Service Reply Comments at 11.

<sup>98</sup> See USPS-LR-R2010-4R/11 “R2010.4R.11.Contribution.Calculation-Rev.10.25.13.xls” tab “Rev & Cont Calc\_08\_12.” The Column “FY 12 Unit Contribution” has been added for clarity. FY 12 Unit Contribution is the “FY 2012 Total Contribution” divided by the “FY 2012 Total Volume.”

**Table IV-6**

**Postal Service Volume and Contribution Loss Calculations  
due to the Great Recession**

	Impact on Mail Volumes					Total	FY 12	FY12	FY 14
	2008	2009	2010	2011	2012	Volume	Unit Contribution	Total Contribution	Contribution
<b>First-Class Mail (domestic)</b>	<b>(3,926.9)</b>	<b>(6,110.1)</b>	<b>(4,994.6)</b>	<b>(4,012.3)</b>	<b>(3,546.2)</b>	<b>(22,590)</b>	<b>\$ 0.22</b>	<b>\$ (4,967)</b>	<b>\$ (5,501)</b>
Single-Piece Letters	(2,051.0)	(2,271.3)	(1,988.0)	(1,595.4)	(1,263.7)	(9,169)	\$ 0.19	\$ (1,739)	\$ (1,994)
Single-Piece Cards	(116.0)	(124.7)	(106.2)	(84.6)	(66.1)	(498)	\$ 0.06	\$ (32)	\$ (51)
Presort Letters	(1,459.3)	(3,261.4)	(2,556.7)	(2,057.3)	(1,977.0)	(11,312)	\$ 0.24	\$ (2,717)	\$ (2,907)
Presort Cards	(109.8)	(227.7)	(167.5)	(137.7)	(129.5)	(772)	\$ 0.15	\$ (118)	\$ (128)
Flats	(190.9)	(224.9)	(176.2)	(137.3)	(109.9)	(839)	\$ 0.43	\$ (361)	\$ (422)
<b>Standard Mail</b>	<b>(6,960.2)</b>	<b>(16,968.4)</b>	<b>(2,060.9)</b>	<b>(1,407.5)</b>	<b>(1,724.5)</b>	<b>(29,121)</b>	<b>\$ 0.06</b>	<b>\$ (1,815)</b>	<b>\$ (2,253)</b>
<b>Periodicals Mail</b>	<b>(165.3)</b>	<b>(517.0)</b>	<b>(479.1)</b>	<b>(195.2)</b>	<b>(266.4)</b>	<b>(1,623)</b>	<b>\$ (0.10)</b>	<b>\$ 161</b>	<b>\$ 120</b>
<b>Package Services</b>	<b>(8.7)</b>	<b>(85.6)</b>	<b>(39.0)</b>	<b>(33.0)</b>	<b>(27.6)</b>	<b>(194)</b>	<b>\$ 0.10</b>	<b>\$ (20)</b>	<b>\$ (31)</b>
<b>International Mail</b>	<b>0.0</b>	<b>(17.0)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>(17)</b>	<b>\$ 0.21</b>	<b>\$ (4)</b>	<b>\$ (4)</b>
<b>TOTAL MARKET-DOMINANT MAIL</b>	<b>(11,061)</b>	<b>(23,698)</b>	<b>(7,574)</b>	<b>(5,648)</b>	<b>(5,565)</b>	<b>(53,546)</b>	<b>\$ 0.12</b>	<b>\$ (6,644)</b>	<b>\$ (7,669)</b>

Using FY 2012 unit contribution, Nickerson estimates that the Postal Service lost approximately \$6.6 billion of contribution because of volume declines caused by the Great Recession. Nickerson Statement at 4. Using projected FY 2014 unit contribution, Nickerson estimates that the Postal Service lost \$7.7 billion of contribution because of volume declines caused by the Great Recession.<sup>99</sup> As detailed in the table, for First-Class Mail Single-Piece Letters the FY 2008 to FY 2012 volume losses total 9.169 billion pieces. The contribution loss from those pieces is \$1.739 billion using the FY 2012 unit contribution or \$1.994 billion using the FY 2014 unit contribution. The Postal Service contends that this methodology is consistent with the requirements of Order No. 864 because it maintains that “the proposed price adjustment comes nowhere near exceeding the net adverse financial impact of the exigent circumstances, and in fact falls far short of it.” Postal Service Reply Comments at 17.

The Postal Service characterizes the methodology described in its Request as a means of obtaining the “annual” amount of lost contribution for FY 2012 and it maintains that it is this annual computation that is the relevant estimate. Postal Service Reply Comments at 14. However, it acknowledges that in order to obtain a cumulative

<sup>99</sup> The FY 2014 unit contribution estimates used in USPS-LR-R2010-4R/11 are obtained from the FY 2014 Before Rates calculations in USPS-LR-R2010-4R/12.

amount of lost contribution over a series of years, it would be necessary to “take the estimates of lost volume in each separate fiscal year and apply to them the relevant unit contributions for that particular fiscal year, and then sum the resulting annual lost contributions across fiscal years.” *Id.* at 16.

The Postal Service suggests that “the most valid estimate of harm” would be an estimate of lost volume in FY 2014 multiplied by FY 2014 unit contributions. *Id.* at 45.

*MPA methodology.* MPA uses the same methodological framework as the Postal Service to translate its estimated volume loss caused by the Great Recession into a contribution loss, although it inputs different volume losses. The following table provides an example of MPA’s methodology and results for FY 2014, with the details provided for First-Class Mail.<sup>100</sup>

**Table IV-7**

**MPA Volume and Contribution Loss Calculations  
due to the Great Recession**

	Impact on Mail Volumes							Total	FY12	FY12	FY 14
	2008	2009	2010	2011	2012	2013	2014	Volume	Unit Contribution	Total Contribution	Total Contribution
<b>First-Class Mail (domestic)</b>	<b>118.8</b>	<b>(1,087.1)</b>	<b>(458.5)</b>	<b>355.6</b>	<b>313.6</b>	<b>117.6</b>	<b>(22.3)</b>	<b>(758)</b>	<b>\$ 0.21</b>	<b>\$ (157)</b>	<b>\$ (169)</b>
Single-Piece Letters	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0	\$ 0.19	\$ -	\$ -
Single-Piece Cards	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0	\$ 0.06	\$ -	\$ -
Presort Letters	108.4	(1,002.1)	(424.9)	328.7	290.1	108.9	(20.7)	(700)	\$ 0.21	\$ (147)	\$ (157)
Presort Cards	8.2	(68.9)	(27.0)	21.9	19.0	6.9	(1.3)	(47)	\$ 0.13	\$ (6)	\$ (7)
Flats	2.1	(16.1)	(6.6)	5.1	4.5	1.8	(0.3)	(11)	\$ 0.37	\$ (4)	\$ (5)
<b>Standard Mail</b>	<b>(2,341)</b>	<b>(8,562)</b>	<b>1,359</b>	<b>872</b>	<b>2,477</b>	<b>929</b>	<b>1,563</b>	<b>(3,704)</b>	<b>\$ 0.06</b>	<b>\$ (209)</b>	<b>\$ (266)</b>
<b>Periodicals Mail</b>	<b>(110)</b>	<b>(377)</b>	<b>(352)</b>	<b>(16)</b>	<b>66</b>	<b>61</b>	<b>52</b>	<b>(676)</b>	<b>\$ (0.10)</b>	<b>\$ 67</b>	<b>\$ 50</b>
<b>Package Services</b>	<b>3</b>	<b>(3)</b>	<b>7</b>	<b>9</b>	<b>7</b>	<b>9</b>	<b>7</b>	<b>39</b>	<b>\$ (0.15)</b>	<b>\$ (6)</b>	<b>\$ (1)</b>
<b>International Mail</b>	<b>11</b>	<b>(17)</b>	<b>13</b>	<b>7</b>	<b>3</b>	<b>0</b>	<b>3</b>	<b>20</b>	<b>\$ 0.21</b>	<b>\$ 4</b>	<b>\$ 4</b>
<b>TOTAL MARKET-DOMINANT</b>	<b>(2,318)</b>	<b>(10,047)</b>	<b>569</b>	<b>1,228</b>	<b>2,867</b>	<b>1,117</b>	<b>1,602</b>	<b>(4,983)</b>	<b>\$ 0.06</b>	<b>\$ (301)</b>	<b>\$ (382)</b>

The differences in contribution losses due to the Great Recession between the Postal Service and MPA are the result of differences in volume estimation methodology. The

<sup>100</sup> See, e.g., MPA et al.-LR-R2013-11/1 “MPA et al.-LR-R2013-11/1 – Improved Approach.xls” tab “Rev & Cont Calc\_08\_14.”

Postal Service and MPA use the same framework to estimate the contribution loss of a given volume loss.

*Public Representative suggested methodology.* The Public Representative contends that lost contribution is only a starting point for determining the amount the Postal Service can recover in an exigent request. PR Comments at 20. He argues that an exigency created by a recession should be analyzed the same way as an exigency created by a natural disaster, such as a tornado that destroys a processing plant. *Id.* at 20-21. He posits a two-step methodology: (1) determining the temporary cost of sustaining the postal network in the face of declining mail volumes; and (2) determining the one-time cost of right-sizing the network to handle anticipated future volumes. *Id.* at 21. The duration of the temporary cost would be determined by estimating how long it would take for the Postal Service to right-size its network and the cost figures could be adjusted downward as the Postal Service made progress toward right-sizing. *Id.* at 21-22. The Public Representative does not calculate an amount recoverable by the Postal Service using his proposed methodology.

*Commission Analysis.* The Commission uses the framework proposed by the Postal Service to demonstrate that “the amount of the proposed adjustment does not exceed the net adverse financial impact.”<sup>101</sup> The Commission uses the Postal Service’s preferred method of multiplying the total volume loss due to the Great Recession by the FY 2014 After Rates contribution. Using the FY 2014 After Rates contribution to calculate the total lost contribution allows for a more meaningful comparison between the total lost contribution and the expected After Rates contribution of \$1.808 billion.<sup>102</sup> The table below contains the Commission’s estimate of total volume loss due to the Great Recession, and the adverse financial impact of that volume loss.

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<sup>101</sup> Order No. 864 at 3.

<sup>102</sup> See Postal Service Reply Comments at 18 (using FY 2014 unit contribution allows a “more apples-to-apples comparison to the FY 2014 increased exigent contribution”).

**Table IV-8**  
**Commission Volume and Contribution Loss Calculations**  
**due to the Great Recession**

	Accelerated Reduction In Volume					FY 2014 AR	
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Volume</u>	<u>Unit Contribution</u>	<u>Total Contribution</u>
<b><u>First-Class Mail</u></b>	(582.7)	(1,863.9)	(1,043.3)	0.0	(3,490.0)	\$ 0.27	\$ (929)
<b><u>Standard Mail</u></b>	(5,350.0)	(15,572.0)	0.0	0.0	(20,922.0)	\$ 0.09	\$ (1,890)
<b><u>Periodicals Mail</u></b>	(110.3)	(377.2)	(352.3)	(15.8)	(855.5)	\$ (0.06)	\$ 52
<b><u>Package Services</u></b>	0.0	(3.4)	0.0	0.0	(3.4)	\$ 0.04	\$ (0)
<b><u>Total</u></b>	(6,043.0)	(17,816.5)	(1,395.6)	(15.8)	(25,270.8)	\$ 0.11	\$ (2,766)

The Commission finds that the Great Recession resulted in losses over a 4-year period, from FY 2008 - FY 2011. The total volume lost in each category of mail during that period is multiplied by the FY 2014 After Rates unit contribution for that category of mail. The product for each category of mail is summed, resulting in a total contribution loss of \$2.766 billion. The detail for this table is set forth in PRC-LR-R2013-11/2.

V. ADDITIONAL CONTRIBUTION FROM RATES OF \$1.808 BILLION IS NECESSARY

The Postal Service contends that the additional net revenue of \$1.808 billion sought in its Request is necessary to maintain and continue to provide postal services of the kind and quality adapted to the needs of the United States. Its witness Nickerson argues that the expected additional contribution is necessary to ensure that the Postal Service maintains a sufficient level of liquidity. Nickerson Statement at 4. He states that the exigent rates requested by the Postal Service are not intended to recover 100 percent of the contribution lost due to the Great Recession; rather, the Postal Service has sought to balance the potential adverse effects of rate increases on mailers and the Postal Service's need for additional liquidity. *Id.* He explains that the Postal Service views additional liquidity as necessary to ensure that it can continue to provide effective and regular postal services. *Id.* at 5. Finally, Nickerson describes the actions the Postal Service has taken and will continue to take to improve its financial position, including efforts to enhance revenue, improve productivity, and reduce costs. *Id.* at 12-14.

Thirteen commenters (or groups of commenters) submitted comments concerning the necessity of an exigent rate increase that would recover the contribution loss attributable to the Great Recession.<sup>103</sup> Most of these commenters conclude that an exigent rate increase is not necessary. NPMHU believes that the Postal Service has demonstrated that the requested rates are necessary. NPMHU Comments at 5.

As explained in Chapter III, 39 U.S.C. § 3622(d)(1)(E) requires the Commission to evaluate whether a proposed exigent rate adjustment is “necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality

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<sup>103</sup> NPPC et al. Comments; NPPC et al. Reply Comments; MPA et al. Comments; Valpak Comments; Valpak Reply Comments; ABA Comments; SIIA & ABM Comments; Valassis Comments; PR Comments; SMC et al. Comments; Boardroom Comments; NPMHU Comments; GCA Reply Comments; FSR & NAMIC Comments; Postal Service Reply Comments.

adapted to the needs of the United States.” This Chapter addresses two issues: (1) whether the Postal Service’s current low liquidity levels compromise its ability to maintain and continue the development of needed postal services; and (2) whether the Postal Service’s Request is necessary to enable it, under best practices of honest, efficient, and economical management, to maintain and continue the development of needed postal services.

A. The Postal Service’s current low liquidity levels compromise its ability to maintain and continue the development of needed postal services

1. Postal Service’s Position

In his Statement, Nickerson explains that additional contribution is necessary because the Postal Service lacks adequate liquidity. Nickerson Statement at 5. The inflation-based price increases for market dominant products cannot adequately address liquidity concerns because the Postal Service’s costs are rising with or above inflation. *Id.* Nickerson states that the exigent rate adjustment is therefore necessary to improve the Postal Service’s liquidity so that the Postal Service can continue providing effective and regular postal services. *Id.*

Nickerson describes the erosion of the Postal Service’s available liquidity over the past five fiscal years. *Id.* at 6. From September 30, 2008 to September 30, 2012, the Postal Service’s liquidity declined by almost \$7 billion. *Id.* Had the Postal Service not defaulted on the two Retiree Health Benefits Fund payments due at the close of FY 2012, its liquidity would have been -\$8.8 billion and it would have had no cash to fund operations. *Id.* In addition, the Postal Service has borrowed its full \$15 billion of legally allowable debt. *Id.* at 5. Nickerson states that the Postal Service has no foreseeable means of paying off its \$15 billion debt and will continue to default on future Retiree Health Benefits Fund payments. *Id.*

Nickerson expects the Postal Service’s liquidity to be approximately \$2.4 billion at the close of FY 2013 and FY 2014 Before Rates, which is approximately nine days of



operating cash. *Id.* at 7. Nickerson explains that the Postal Service's projection of relatively constant levels of liquidity for FY 2013 and FY 2014 is due to the continuation of the Postal Service's cost reduction initiatives and improvements in revenue. *Id.* Other factors expected to favorably influence liquidity in 2014 include: the full-year availability of a lower-cost, non-career workforce; continuing consolidations of network facilities, transportation, and delivery operations; continued savings from reduced retail hours; and cost savings in air transportation. *Id.*

Nickerson asserts that the forecasted liquidity level of approximately \$2.4 billion at the close of FY 2014 is grossly inadequate. *Id.* He explains that the Postal Service's biweekly payroll cost is approximately \$1.7 billion and available cash at the close of FY 2013 and FY 2014 will be only \$700 million above biweekly payroll. *Id.* at 7-8. In mid-October of each year, the Postal Service is required to make a payment for workers' compensation to the Department of Labor of approximately \$1.4 billion. *Id.* at 8. Nickerson maintains that sufficient liquidity must be available to make the payment to the Department of Labor, pay biweekly payroll, and maintain some margin of safety. *Id.*

Currently, Nickerson believes that any number of possible events or circumstances could push the amount of cash below the payroll amount, which would imperil the Postal Service's continued operation. *Id.* For example, a \$1.0 billion reduction in revenues below projections, the average revenue decrease over the last three completed fiscal years, could reduce liquidity by \$400 to \$500 million, depending on mail volume and mix and assuming timely execution of workhour reductions. *Id.* Nickerson asserts that scenarios in which economic circumstances result in an even greater reduction in revenue are possible. *Id.*

Nickerson also explains the impact inflation has on Postal Service costs. *Id.* Increases in CPI increase annual wage, transportation, and healthcare costs. *Id.* Nickerson asserts that the current and projected levels of liquidity are insufficient to allow the Postal Service to absorb any significant financial adversity. *Id.*

Nickerson contrasts the Postal Service's level of liquidity to the liquidities of FedEx and UPS. *Id.* at 8-9. Despite being two-thirds the size of the Postal Service, FedEx had \$4.9 billion in cash on May 31, 2013 and an available \$1 billion line of credit—for a liquidity roughly 2.5 times that of the Postal Service. *Id.* at 9. UPS had \$7.9 billion in cash and marketable securities on December 31, 2012 and an unused \$10 billion commercial paper program for an even greater liquidity of \$17.9 billion. *Id.*

Nickerson asserts that moving forward, liquidity pressures on the Postal Service will continue to increase. *Id.* Many of the financial benefits that the Postal Service expects to realize due to operational and workforce initiatives will be completed in 2014. *Id.* For example, during 2013, the Postal Service worked to maximize the number of lower-cost non-career employees. *Id.* at 10. The full year effects of that maximization will be captured in 2014. *Id.* In 2015 and 2016, the savings from non-career employees will decrease, as the total career employee numbers decrease because the ratio of career to non-career employees must remain constant in accordance with current union contracts. *Id.* Savings from consolidating mail processing operations, delivery units, carrier routes, and transportation are one-time savings. *Id.* Nickerson also notes that there is a limit below which infrastructure reductions cannot occur without a reduction in service. *Id.*

Nickerson believes that planned cost savings will not be sufficient to offset inflationary pressures on costs and that the cost saving initiatives within the Postal Service's control will not, by themselves, be sufficient to improve the Postal Service's liquidity position. *Id.* at 9. For example, union contracts call for annual wage increases and cost-of-living adjustments from 2014 through contract expiration. *Id.* at 10. While the 2014 increases are offset by operational and cost savings, the inflationary pressures will become more apparent in 2015 after the effects of the cost saving initiatives have been realized. *Id.*

Nickerson also asserts that it is likely mail volumes will continue to decline beyond 2014. *Id.* at 11. He notes that First-Class Mail volumes have decreased every

year since 2001 and that there is no reason to believe the trend will change. *Id.* He does not anticipate the growth in package volume will be sufficient to offset the contribution loss by the continuing volume decline in First-Class Mail. *Id.*

Nickerson explains that one of the mechanisms the Postal Service has used to remain solvent is the deferral of capital investments, which have declined from \$2.0 billion in 2008 to \$0.7 billion in 2012. *Id.* Nickerson states that this low level of capital spending cannot be maintained indefinitely. *Id.* As an example, he notes that much of the Postal Service's delivery fleet is nearing the end of its useful life. *Id.* He states that the exigent rate adjustment will give the Postal Service greater ability to make necessary capital investments. *Id.*

In addition to the operational and contractual requirements, the Postal Service has two legally-mandated cash outlays that will begin in 2017. *Id.* Beginning in 2017, the Postal Service will be required to pay any unfunded Civil Service Retirement System (CSRS) actuarial liability under a 27-year amortization schedule, the actuarially-determined normal costs of providing retiree health benefits, and any remaining unfunded liability. *Id.* at 11-12. Nickerson asserts that the size of these mandates dictates that the Postal Service begin to generate the additional liquidity now. *Id.* at 11.

As of August 31, 2013, the Postal Service held \$15.0 billion in debt, a workers' compensation liability of \$16.5 billion, and an unpaid Retiree Health Benefits prefunding liability of \$16.3 billion. *Id.* at 12. Nickerson asserts that the modest increase in cash flow from the exigent rate adjustment is an important step in alleviating the Postal Service's financial difficulties so that it can provide effective and regular postal services and pay down some of its debt in the short term. *Id.*

If the Postal Service implements the exigent rate adjustment, the price increases set forth in Docket No. R2013-10, and the competitive product price increases set forth in Docket No. CP2014-5 in January 2014, and continues to default on its Retiree Health Benefits Fund payments, Nickerson expects available liquidity to be \$4.505 billion, or 17

days of operating expenses, by the end of 2014. *Id.* The \$1.4 billion workers' compensation payment would be due just 15 days later—leaving the Postal Service with a liquidity level Nickerson asserts is “well below...that a financially sound private sector company would have[.]” *Id.*

a. Comments

*Initial comments.* SIIA and ABM note that recent revenue numbers and forecasts from the Postal Service indicate that the Postal Service's financial situation has been improving. SIIA & ABM Comments at 3. They note that the Postal Service recorded its first revenue growth since FY 2008 for FY 2013, despite the continued decline in volumes. *Id.* They also note that if the \$5.5 billion for future retiree health benefits is excluded, the Postal Service would have made a small profit in FY 2013. *Id.* They emphasize that the positive signs that have emerged in the last year indicate that now is not the time to increase Postal Service revenues with an exigent rate increase. *Id.* MPA also notes the recent improvements and questions whether an exigent rate increase is necessary at all, in light of the fact that the Postal Service has as much cash on hand as it did a year ago, and projects to have the same amount of cash on hand next year without the requested exigent rate adjustment. MPA et al. Comments at 55 n.12.

The Public Representative criticizes Nickerson's assessment of the necessity of the requested price increase, noting that Nickerson states that the increase will allow for capital investments, debt repayment, and allow for financial breathing room. PR Comments at 14. The Public Representative contends that the exigent rate adjustment should be used to deal with specific exigencies, rather than deal with “optional expenditures” or create “breathing room” to deal with matters unrelated to the exigency. *Id.*

Valpak believes that the Postal Service's liquidity problems have arisen from its practice of pricing products below their costs. Valpak Comments at 61. Valpak asserts

that the exigent rate adjustment would not be necessary if the Postal Service priced its below cost products in an economically efficient manner. *Id.* at 69. Valpak concludes that “the Postal Service’s current liquidity problem must be seen for what it is – a self-inflicted wound[.]” *Id.* at 106.

FSR and NAMIC assert that the exigent rate adjustment would, at best, only assist with the Postal Service’s fiscal situation in the short term. FSR & NAMIC Comments at 12-13. They contend that the exigent rate adjustment will not be sufficient to place the Postal Service on firm financial ground in the long term. *Id.* at 13. ABA also believes that an exigent rate adjustment is not a comprehensive solution. ABA Comments at 8. It notes that even if the exigent rate adjustment is granted, it would raise approximately \$1.78 billion, significantly less than \$5 billion in losses the Postal Service faces in FY 2013. *Id.* ABA acknowledges that the exigent rate adjustment would provide some revenues to offset the current loss, but notes that the increase could also negatively impact mail volume and hurt overall postal operations. *Id.* Valassis notes that the requested increases only extend the Postal Service’s cash to cover fifteen to sixteen days of operating costs and questions whether the increases are necessary to allow the Postal Service to continue postal services of the kind and quality adapted to the needs of the American people. Valassis Comments at 32.

Valassis also advocates for an interpretation of the phrase “postal services of the kind and quality adapted to the needs of the United States” that considers the importance of “a healthy, thriving postal industry” as “most beneficial to the nation as a whole[.]” *Id.* at 34. GCA supports Valassis’ comments, agreeing with Valassis’ view that the “necessary” portion of the statute should relate to the environment for all mail. GCA Reply Comments at 28.

*Reply Comments.* NPPC agrees with Valassis’ assessment that the Postal Service has not shown that the requested increases are “necessary.” NPPC et al. Reply Comments at 6 n.3. NPPC emphasizes that the Postal Service has not stated

that it will be unable to pay its bills over the next several years, but rather that the Postal Service has less liquidity than UPS and FedEx. *Id.*

In its Reply Comments, the Postal Service asserts that adequate liquidity is necessary for the Postal Service to “maintain” provision of postal services and that it is also necessary to make essential capital investments so the Postal Service can continue the development of those postal services. Postal Service Reply Comments at 72. The Postal Service contends that it is necessary for the Postal Service to plan for and guard against contingencies and it would be improper to consider the Request in a vacuum in which all consideration of the Postal Service’s overall financial condition is ignored. *Id.* The Postal Service states that maintenance of liquidity is essential for ensuring the continued provision of services “of the kind and quality adapted to the needs of the United States” which it asserts ties the Request directly to the maintenance of postal operations. *Id.* at 78. The Postal Service contests Valassis’ assessment that the “needs of the United States” include a healthy, thriving postal industry. *Id.* at 75.

The Postal Service responds to the Public Representative’s comments concerning the import of improved liquidity levels. *Id.* at 79. The Postal Service argues that the expenditures that the Public Representative characterizes as “optional” are “the very things that the Postal Service must prudently do in order to “maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.”” *Id.* It asserts that employee wages, expenses paid to highway contractors and suppliers, and fuel for postal vehicles are not optional and that funds for capital investments are necessary to allow for continued service. *Id.*

The Postal Service also contests MPA’s comment calling into question the necessity of the Request because the Postal Service’s liquidity situation improved in FY 2013. *Id.* at 78 n.18. The Postal Service references Nickerson’s Statement and maintains that the current level of liquidity is “simply too low to be prudently maintained.” *Id.*

b. Commission Analysis

39 U.S.C. § 3622(d)(1)(E) requires that any exigent rate adjustment be “necessary to enable the Postal Service . . . to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” In order for an exigent rate adjustment to go into effect, the Postal Service must show and the Commission must find that the additional contribution requested is required in order for the Postal Service to both maintain needed postal services and continue the development of needed postal services.

Valassis and GCA contend that “postal services of the kind and quality adapted to the needs of the United States” requires consideration of the importance of “a healthy, thriving postal industry.” Valassis Comments at 34; GCA Reply Comments at 28. The health of the postal industry is far removed from Congress’s language in section 3622(d)(1)(E)’s “necessary clause,” which focuses entirely on the Postal Service’s ability to maintain and continue the development of postal services.

The Postal Service’s universal service obligation (USO) is set forth in 39 U.S.C. § 101(a) and provides a framework for analyzing the types of postal services that are “of the kind and quality adapted to the needs of the United States.” The USO states that “[t]he Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people.” 39 U.S.C. § 101(a).

The USO is a flexible policy that captures the Postal Service’s obligation to provide postal services adapted to the Nation’s evolving needs. As discussed in Chapter III, *supra*, and the USO Report, the Nation’s postal needs are not stagnant and evolve over time, and therefore (at 18), the evaluation of the Nation’s postal needs in this proceeding must consider the specific facts on which the Postal Service bases its Request. USO Report at 18. In addition, the Commission finds that the fundamental tenets of the USO, as described in the USO Report, remain relevant to the Nation’s

postal needs today, including the need for “ready access” to “essential postal services”;<sup>104</sup> nationwide delivery of mail; and provision of postal services throughout the United States, its territories and possessions; to and from foreign regions pursuant to agreements with the United States military, United States agencies, and agreements relating to international postal services and international delivery services. *Id.* at 19-20, 23.

*Current financial condition.* The Postal Service’s overall financial condition is relevant to the Commission’s analysis because an exigent rate adjustment would not be necessary if the Postal Service had the ability to maintain and continue the development of the Nation’s needed postal services independent of an exigent rate adjustment. This protects the integrity of the price cap by ensuring that rates are increased above inflation only when the Postal Service does not have other sources of funds that it can use to maintain postal services.

As the Commission recognized in the FY 2011 ACD, “[l]iquidity, or the availability of cash through operating revenues and debt, is the most important requirement for any business organization.”<sup>105</sup> The Commission then stated that “[w]ithout the ability to generate sufficient cash from business operations, or to access sufficient debt capacity to invest in the business, an organization cannot continue to operate.” *Id.* Table V-1 illustrates the rapid decline in the Postal Service’s available liquidity from FY 2007 to FY 2013.

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<sup>104</sup> “Essential postal services” include postal products, mail acceptance points, access to letter carriers, and easily accessible information. *Id.* at 19.

<sup>105</sup> Annual Compliance Determination Report, Fiscal Year 2011, March 2012, at 22, available at <http://www.prc.gov/Docs/81/81771/FY%202011%20ACD.pdf> (FY 2011 ACD).



**Table V-1**

**Postal Service Year-End Liquidity FY 2007 to FY 2013  
(\$ in Millions)**

	<b>FY 2007</b>	<b>FY 2008</b>	<b>FY 2009</b>	<b>FY 2010</b>	<b>FY 2011</b>	<b>FY 2012</b>	<b>FY 2013</b>
<b>Cash and Cash Equivalents</b>	899.4	1,431.8	4,089.5	1,161.2	1,487.5	2,318.8	2,637.5
<b>Current portion of Debt</b>	4,200.0	7,200.0	3,675.0	7,500.0	7,500.0	9,499.6	9,799.6
<b>Long-Term Debt</b>	0.0	0.0	6,525.0	4,500.0	5,500.0	5,500.0	5,200.0
<b>Total Debt</b>	4,200.0	7,200.0	10,200.0	12,000.0	13,000.0	14,999.6	14,999.6
<b>Statutory Debt Limit</b>	15,000.0	15,000.0	15,000.0	15,000.0	15,000.0	15,000.0	15,000.0
<b>Available Debt</b>	10,800.0	7,800.0	4,800.0	3,000.0	2,000.0	0.4	0.4
<b>Total Liquidity (Cash + Available Debt)</b>	11,699.4	9,231.8	8,889.5	4,161.2	3,487.5	2,319.2	2,637.9
Source: USPS Form 10-K, FY 2007 – 2013.							

As Table V-1 demonstrates, the Postal Service's available liquidity declined from approximately \$11.7 billion at the close of FY 2007 to approximately \$2.6 billion just six years later. It shows that the Postal Service has reached, for all practical purposes, its \$15 billion statutory debt limit.

Table V-1 also demonstrates that the Postal Service had a slight improvement in both cash and cash equivalents and total liquidity between FY 2012 and FY 2013. Several commenters question the necessity of the requested price increases in light of the improved financial picture. See SIIA & ABM Comments at 3; MPA et al. Comments

at 55 n.12. While the Postal Service had a modest improvement in overall liquidity in FY 2013, and expects to maintain a similar level of liquidity in FY 2014, any gains are expected to be short-lived and are not demonstrative of a significant change in financial health.

The recent improvements in liquidity are due to the continuation of cost-cutting initiatives and improvements in revenue. See Nickerson Statement at 7. However, as previously noted, many benefits of the cost reduction initiatives will be fully realized in FY 2014. For example, FY 2014 will be the first year the Postal Service realizes the full year effects of the maximization of its non-career workforce. *Id.* at 10. Other savings, like consolidations of network facilities and delivery operations, derive from one-time actions, and additional savings cannot be achieved without a further reduction in service or mailing service standards.<sup>106</sup>

At the same time, many of the Postal Service's costs continue to rise at or above inflation. Nickerson Statement at 5. For example, inflationary pressures, though currently minimal, can increase the Postal Service's annual wage, transportation, and healthcare costs. *Id.* at 8. Union contracts mandate annual wage increases and cost of living adjustments from 2014 forward. *Id.* at 10. While the Postal Service expects its cost reduction initiatives to cover these additional costs in FY 2014, it also expects its costs to continue to rise without being able to realize corresponding savings starting in FY 2015. *Id.*

The Commission finds that the Postal Service's improving liquidity does not negate the necessity of its Request. The improvements in FY 2013 are slight and do not indicate any new trends of significant liquidity growth. Instead, the improvements illustrate the positive effects of the Postal Service's cost-cutting measures, the benefits of which will be primarily realized by the close of FY 2014.

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<sup>106</sup> *Id.* The Postal Service has already altered market dominant service standards in two phases as a consequence of its Network Rationalization initiative. See Revised Service Standards for Market-Dominant Mail Products, 77 Fed. Reg. 31,190 (May 25, 2012) (codified at 39 C.F.R. part 121).

*Additional liquidity is necessary.* In the FY 2012 ACD, the Commission voiced concern about the Postal Service's low levels of liquidity.<sup>107</sup> In the face of continued losses, the Commission was concerned that the Postal Service would be "unable to finance capital investment to replace deteriorating assets and make improvements to other capital assets to further improve productivity." FY 2012 ACD at 27. The Commission noted that maintaining and improving service is important for retaining existing volume and that continued reduced levels of capital spending would lead to the deterioration of assets and reductions in service performance. *Id.* at 27, 29.

While several commenters argue that the need for additional liquidity is not a justification for an exigent rate adjustment.<sup>108</sup> Nickerson's Statement goes beyond the concerns the Commission raised in the FY 2012 ACD and demonstrates that additional liquidity is necessary for the Postal Service to both maintain the Nation's needed postal services and continue the development of those services. The Postal Service's liquidity at the close of FY 2013, and projected for close of FY 2014, is only \$700 million over biweekly payroll. Nickerson Statement at 8. Each October, a few weeks after the close of the fiscal year, the Postal Service must make a payment to the Department of Labor for workers' compensation.<sup>109</sup> The Postal Service's level of liquidity is low enough that sudden, unforeseen declines in volumes or increases in costs have the potential to wipe out the Postal Service's remaining liquidity. *Id.*

The Postal Service has deferred capital investments to preserve liquidity. FY 2012 ACD at 29; Nickerson Statement at 11. Table V-2 illustrates the decline in annual capital outlays from FY 2007 to FY 2013.

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<sup>107</sup> Annual Compliance Determination Report, Fiscal Year 2012, March 2013, available at [http://www.prc.gov/PRC-DOCS/UploadedDocuments/2012\\_PRC\\_ACD\\_3108.pdf](http://www.prc.gov/PRC-DOCS/UploadedDocuments/2012_PRC_ACD_3108.pdf) (FY 2012 ACD).

<sup>108</sup> See, e.g., PR Comments at 14; Valpak Comments at 61, 106.

<sup>109</sup> *Id.* The workers' compensation amount varies year-to-year. The amount due in October 2013 for workers' compensation was \$1.4 billion.

**Table V-2**

**Annual Capital Outlays FY 2007 to FY 2013  
(\$ in Millions)**

<b>FY Year</b>	<b>Capital Outlay Amount</b>
FY 2007	2,715
FY 2008	1,995
FY 2009	1,839
FY 2010	1,393
FY 2011	1,190
FY 2012	705
FY 2013	667
Source: USPS Form 10-K, Cash Flow Statements, FY 2007 – 2013.	

While low levels of capital outlays were necessary to maintain solvency, capital outlays must be increased in order for the Postal Service to maintain and continue to develop the Nation's needed postal services. Low levels of capital investment have impaired the Postal Service's ability to maintain and improve business assets. See FY 2012 ACD at 29. Important assets that are not being replaced will deteriorate due to normal wear and tear and maintenance costs will increase. *Id.* Nickerson explains that the Postal Service's delivery fleet is near the end of its useful life. Nickerson Statement at 11. Postal Service delivery vehicles are an average of 24 years old and as the Postal Service delivers more packages, it may need vehicles of a different layout. Tr. 2/180. The U.S. Government Accountability Office has estimated that the cost of additional vehicles would be \$5.8 billion.<sup>110</sup> The Commission previously recognized that

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<sup>110</sup> *Id.* For the full U.S. Government Accountability Office Report on the Postal Service's Aging Delivery Fleet, see U.S. Gov't Accountability Office, United States Postal Service: Strategy Needed to Address Aging Delivery Fleet, GAO-11-386 (May 5, 2011). See also Office of Inspector General, United States Postal Service, Readiness for Package Growth-Delivery Operations, Management Advisory Report, Report Number DR-MA-14-001, December 11, 2013, at 8, available at <http://www.uspsoig.gov/sites/default/files/document-library-files/2013/dr-ma-14-001.pdf>.

deterioration concerns are also true of other key Postal Service assets, including Automated Postal Centers. FY 2012 ACD at 29.

The consequences of continued low levels of liquidity and related low levels of capital investment are significant to the entire postal system. If the Postal Service is unable to repair, maintain, and replace its fleet of delivery vehicles, it could very quickly lose its ability to meet the delivery requirements of the USO. Similarly, if important pieces of machinery are unable to be repaired and replaced, service performance and the Nation's "ready access" to postal services will be substantially impacted.

The proposed price increase can only be approved if it is necessary to enable the Postal Service to maintain and continue the development of the Nation's needed postal services. The Postal Service's current liquidity levels severely jeopardize its ability to make the investments necessary to maintain universal service and continue the development of the Nation's needed level of postal services. Regardless of whether the Postal Service uses the revenues from the increased rates to build liquidity by paying down debt or increasing cash on hand, or to make immediate capital expenditures, the increased contribution is necessary to enable the Postal Service to maintain the needed level of postal services and continue the development of those services moving forward.

*Increased liquidity does not solve the Postal Service's financial problems.* Several commenters assert that increased revenues from the exigent rate adjustment will not solve the Postal Service's long-term financial challenges. FSR & NAMIC Comments at 12-13; ABA Comments at 8; Valassis Comments at 32. Nickerson acknowledges that the Postal Service will still have a liquidity problem even if the Request is granted. Response to POIR No. 7, question 3. He describes the Postal Service's liquidity problem as "continuous and overwhelming" and states that a truly healthy liquidity position can only be achieved through modification of the current legal environment in which the Postal Service operates, combined with additional revenue growth. *Id.* Nickerson nonetheless believes that the requested price increase would alleviate some of the financial pressure experienced by the Postal Service, by

increasing the Postal Service's cash flow to cover over two weeks of operating expenses, an increase over the FY 2014 Before Rates projection of nine days of operating expenses. Tr. 2/178; Nickerson Statement at 7, 12.

Section 3622(d)(1)(E) does not require that the exigent rate adjustment completely alleviate financial challenges, only that the price increase is necessary to allow the Postal Service to maintain and continue the development of needed postal services. At present, the Postal Service's liquidity levels are so low that they pose an unreasonable risk to the Postal Service's continued operation. Without additional contribution, the ability of the Postal Service to continue to meet the Nation's postal needs will be severely compromised. In conclusion, the Commission finds that the Postal Service has shown that the requested exigent rate adjustment is necessary to allow it to maintain and continue the development of needed postal services.

- B. The proposed rate adjustment is necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of needed postal services.

39 U.S.C. § 3622(d)(1)(E) requires that the Postal Service's rate adjustments pursuant to an exigent request be "necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." Because the "necessary" analysis hinges on the particulars of the Request, the following section discusses the Commission's framework for determining whether this exigent rate adjustment is necessary to enable the Postal Service, "under best practices of honest, efficient, and economical management," to maintain and continue the development of needed postal services. 39 U.S.C. § 3622(d)(1)(E). It also analyzes arguments concerning cost-cutting, rate design, and delay in light of that framework.

1. Best practices of honest, efficient, and economical management

The Postal Service and other commenters disagree about the scope of the best practices standard and the content of the standard (that is, the type of actions required by the standard). As discussed in Chapter III, the Commission finds that the best practices standard is primarily a forward-looking standard that varies depending on the circumstances of an exigent request. However, the Postal Service's response to the extraordinary or exceptional circumstances giving rise to the Request inform the determination of whether the Request is necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of needed postal services.

*Scope of best practices.* The Postal Service supports a "prospective" application of the best practices requirement. Request at 19. It relies on the terms "enable," "maintain," and "continue" to conclude that the plain language of section 3622(d)(1)(E) establishes a forward-looking standard. *Id.* It asserts that "a party's claims that the Postal Service is being managed in a manner inconsistent with 'honest, efficient, and economical management' are only relevant if the purported 'inefficiencies' are perpetuated going forward."<sup>111</sup>

The Postal Service suggests that, in addition to factoring into the Commission's determination of necessity, the best practices analysis creates an ongoing requirement to use best practices in connection with exigent rate increases. It explains that "concerns that the prospect of future requests might encourage the Postal Service to become lax in its efforts to reduce costs are misplaced: if the Postal Service did so, any such future request could be rejected for failure to meet the 'honest, efficient, and

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<sup>111</sup> *Id.* When the Commission issued its proposed price cap rules, the Postal Service suggested that an exigent request is appropriate in "extraordinary or exceptional situations in which the [price] cap cannot be met even through honest, efficient, and economical management." Docket No. RM 2007-1, Order Proposing Regulations to Establish a System of Rulemaking, August 15, 2007, at 41-42 (Order No. 26). This suggests that the Postal Service may view its previous response to an extraordinary or exceptional circumstance as relevant to determining whether an exigent request is necessary.

economical management' standard; it would also give the Commission a basis to rescind the current request." Postal Service Reply Comments at 118.

Similarly, NPPC suggests that "even if the Commission were to determine that the Postal Service has suffered some financial losses due to the 2007-2009 recession, it could approve adjusting rates only if the Postal Service had proven that the adjustments were, *looking forward*, 'reasonable and equitable and necessary.'"<sup>112</sup>

However, the comments on best practices of honest, efficient, and economical management generally focus on the Postal Service's past behavior. For instance, Valpak quotes approvingly a Postal Service filing from Docket No. R2010-4R, arguing that, "[t]o the extent the Postal Service has failed to control costs in a manner that is inconsistent with [best practices of honest, efficient, and economical management], the Commission has a statutory basis to deny or reduce the Postal Service's request." Valpak Comments at 15-16. In other words, Valpak argues that if the Postal Service has failed to use best practices in the past, an exigent rate adjustment is not necessary.

As explained in Chapter III, the Commission finds that the best practices standard is primarily a forward-looking standard but that, in general, some consideration of the Postal Service's response to the circumstances giving rise to the Request is appropriate. The timeframe covered by this inquiry will vary depending on the specific circumstances of the exigent request. In the context of this Request, the Commission takes into consideration the Postal Service's response to adverse effects of the Great Recession, beginning when those adverse effects were first manifested.

A finding that the Postal Service has failed to use best practices at any point since the adverse effects of the Great Recession were first felt would not, in itself, prevent a finding that the proposed rate adjustment was necessary. Section 3622(d)(1)(E) does not require the Commission to make specific findings regarding the

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<sup>112</sup> NPPC et al. Reply Comments at 5 (emphasis added). Unlike the Postal Service, however, NPPC concludes that this burden of proof has not been met. *Id.*



use of best practices in the past or in the future. Instead, it requires the Commission to evaluate whether the Postal Service's Request is "necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development" of needed postal services. In a certain sense, the evaluation of necessity presupposes the use of best practices. It asks whether an exigent rate increase would be necessary to maintain and continue the development of needed postal services, even if the Postal Service uses best practices of honest, efficient, and economical management. As explained below, the record in this docket does not show that the Postal Service's management practices have rendered its Request less necessary or unnecessary.

*Content of standard.* Title 39, United States Code, does not define or otherwise identify "best practices of honest, efficient, and economical management." The term "honest, efficient, and economical management" originates in the Act that established the Postal Service, the Postal Reorganization Act.<sup>113</sup> The Committee Report accompanying H.R. 17070 (which, after amendment in conference, was enacted as the Postal Reorganization Act) evinced a desire to "[e]liminate serious handicaps that are now imposed on the postal service by certain legislative, budgetary, financial, and personnel policies that are outmoded, unnecessary, and inconsistent with modern management and business practices that must be available if the American public is to enjoy efficient and economical postal service."<sup>114</sup> It does not specify what those modern management and business practices would be. Likewise, no commenter suggests a comprehensive set of standards that would constitute best practices for Postal Service management. The Commission has never reached the issue of what constitutes best

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<sup>113</sup> 39 U.S.C. §§ 101 *et seq.* The term "best practices" was added by the PAEA.

<sup>114</sup> 91st Cong., H. Rep. 91-1104, Postal Reorganization and Salary Adjustment Act of 1970, May 19, 1970, at 2. See *also id.* at 12 (describing new tenure standards for the Postmaster General that would bring to the Postal Service "the enhanced efficiency and improved productivity that modern American management techniques can offer").

practices of honest, efficient, and economical management for purposes of section 3622(d)(1)(E).<sup>115</sup>

Commenters have identified several practices they believe are indicators of the use of best practices. These include:

- Aggressive cost cutting, including efforts to reduce workhours and the size of the workforce;<sup>116</sup>
- Rational rate setting that adheres to economic principles and reflects accurate elasticity estimates;<sup>117</sup> and
- Compliance with applicable legal standards.<sup>118</sup>

Several commenters compare the management of the Postal Service unfavorably to the management of private sector businesses, especially with reference to cost-cutting efforts. See, e.g., Valpak Comments at 68, n.50, 91; NPPC et al. Comments at 31-32; Valassis Comments at 29-30; Boardroom Comments at 2. The Postal Service responds that it is subject to a unique set of “legal, contractual, and political” constraints. Request at 18; see *also* Postal Service Reply Comments at 103.

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<sup>115</sup> Order No. 547 speculated on Congressional intent concerning the term “best practices of honest, efficient, and economical management” but did not engage in a meaningful analysis. Order No. 547 at 23 (“Congress most likely added the ‘best practices of’ with the intent to establish a stricter standard.”). The quoted language from the Report of the President’s Commission on the United States Postal Service concerns recommendations for reforming the Board of Governors and cannot be construed as a statement of Congress’ intent with respect to 39 U.S.C. § 3622(d)(1)(E).

<sup>116</sup> Valpak Comments at 89, 95-99 (arguing the Postal Service should have converted from door delivery to curbside delivery); SIIA & ABM Comments at 3 (agreeing with report by the Postal Service Inspector General finding that the Postal Service used more workhours than necessary in FY 2012); Valassis Comments at 29-30 (positing that Postal Service has not “cut its unnecessary costs to the bone”); NPMHU Comments at 6 (describing decrease in the number of career Postal Service employees).

<sup>117</sup> Valpak Comments at 60, 99-106 (Postal Service pricing is neither efficient nor economical); NPPC et al. Comments at 31 (“[g]ood management does not raise prices to a counter-productive degree”); SMC et al. Comments at 3, 7 (across-the-board rate increase is “not good business judgment”); GCA Comments at 28 (own-price elasticity of major mail categories has been underestimated). See *also* UPS Comments at 12; Pitney Bowes Comments at 1.

<sup>118</sup> Postal Service Reply Comments at 96 n.31, 97-98, 102 (describing impact of legal obligations on management decisions).

It asserts that some of its costs “reflect constraints imposed by Congress” that are outside the Postal Service’s control. Request at 18. It includes “employee prerogatives and perquisites” among these constraints. *Id.* at 20.

The Commission finds that the unique framework within which the Postal Service must operate is a relevant consideration in determining what constitutes best practices. The Postal Service is charged with providing postal services as a public service. 39 U.S.C. § 101. This responsibility suggests that, for the Postal Service, “best practices of honest, efficient, and economical management” means something more than attempting to maximize retained earnings.<sup>119</sup>

Consequently, in determining whether a rate increase pursuant to an exigent request is necessary, the Commission examines whether the Postal Service’s management practices appropriately balance financial responsibility and the need to provide postal services of the kind and quality adapted to the needs of the United States. This approach includes, at a minimum, an examination of the Postal Service’s efforts to comply with statutory and regulatory requirements, such as Commission orders and Annual Compliance Determinations. However, Congress did not establish (and commenters do not suggest) a specific set of criteria for what constitute best practices. To the contrary – the statute implies that a fixed set of standards would have limited utility, since best practices are likely to evolve as the Postal Service adapts the kind and quality of the postal services it provides to the changing needs of the United

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<sup>119</sup> This is not to suggest the maximization of retained earnings should not be part of the Postal Service’s management practices, but to note the PAEA requires the Postal Service to operate both as a financially responsible business and as a public service. *Compare* Order No. 547 at 70 (“One objective of the PAEA was to ensure adequate revenues, including retained earnings, to allow the Postal Service to maintain financial stability.”) *with* 91st Cong., H. Rep. 91-1104, Postal Reorganization and Salary Adjustment Act of 1970, May 19, 1970, at 19 (“The Postal Service is – first, last and always – a public service. H.R. 17070 is designed to prevent public service from involving public wastefulness in postal matters. This must be done not only by requiring postal management to operate efficiently and economically, but also by requiring it to seek out the needs and desires of its present and potential customers – the American public.”).

States. Thus, the Commission determines the nature of best practices on a case-by-case basis, taking into consideration the totality of the circumstances.

## 2. Cost-cutting

As explained above, the Commission's analysis of best practices is primarily forward-looking. However, the Postal Service's efforts to cut costs in response to the effects of the Great Recession inform the Commission's evaluation of the necessity of the Request. In this section, the Commission examines the Postal Service's efforts to cut costs in response to the Great Recession and finds that these efforts do not reduce or eliminate the necessity of a rate increase to enable the Postal Service to maintain and continue the development of needed postal services.

### a. Comments

*Postal Service cost-cutting efforts.* The Postal Service argues that its recent track record and future plans are sufficient to find that it has used best practices in the past. Request at 21-33; Postal Service Reply Comments at 91-108. Nickerson summarizes Postal Service efforts to cut costs in the past and its plans to continue to do so in the future. Nickerson Statement at 12-14. He notes that the Postal Service has reduced workhours from 1,423 million in 2007 to 1,122 million in 2012. *Id.* at 12-13. This reduction was achieved through separation and retirement incentives, reduction in overtime, and consolidation of district and area offices. *Id.* at 13. The Postal Service's most recent Five-Year Business plan involves several additional cost-cutting measures, including: (1) increasing mail processing network efficiency; (2) reducing retail hours at post offices; (3) consolidating delivery offices and expanding centralized delivery; (4) establishing Village Post Offices and expanding online access to postal services; (5) reducing labor costs in new labor contracts; and (6) reducing the career workforce by 23 percent. *Id.* at 13-14. The Postal Service provides expanded descriptions of its cost-cutting efforts in its Response to POIR No. 10, question 5; Response to POIR No. 11, question 13; and its Reply Comments.

It points out that the Commission has previously described Postal Service efforts to cut costs and improve efficiency as “commendable.” Postal Service Reply Comments at 94, quoting Order No. 547 at 61 n.48, 80-86. It also cites comments from UPS describing efforts to cut costs as “impressive.” *Id.* at 94, quoting UPS Comments at 5.

NPMHU argues that the Postal Service’s cost-cutting efforts have required difficult sacrifices. NPMHU Comments at 5-6. It focuses on reductions in the number of workhours, the number of career mail handlers, and the number of processing facilities. *Id.* at 6-7. It argues that further cost-cutting measures would result in a decline in service standards, as evidenced by the Postal Service request to end the overnight service standard. *Id.* at 6.

Valassis “does not in general take issue with” the Postal Service’s argument that it has exercised best practices of honest, efficient, and economical management and plans to continue to do so in the future. Valassis Comments at 23. It does, however, believe that these efforts do not demonstrate that a rate increase is necessary. *Id.*

*Additional cost cutting necessary.* Three commenters contend that the Postal Service has not done enough to cut costs. SIIA and ABM cite a recent report by the Postal Service Inspector General, which found that the Postal Service is not capturing all possible cost savings that could be realized in light of reduced mail volume. SIIA & ABM Comments at 3; see *also* Valpak Reply Comments at 3. On this basis, SIIA and ABM conclude that the Postal Service “has not been on the leading edge of adjusting their business model to the new economy” and that the Commission should allow the Postal Service more time to adapt to the economic situation rather than approving a rate increase. SIIA & ABM Comments at 3.

Valpak argues that the Postal Service has neither achieved nor aggressively sought cost-cutting measures. Valpak Comments at 89. It also objects that the Postal Service has not provided timely or complete responses to inquiries concerning its

cost-cutting efforts. Valpak Reply Comments at 3. Valpak contends that the Postal Service should have pursued measures like involuntary termination rather than separation incentives and curbside delivery rather than door delivery. Valpak Comments at 92, 95. It maintains that the Postal Service's failure to convert to curbside delivery is evidence that it "would prefer to breach the price cap and continue to impose the costs of expensive door delivery on mailers, all the while blaming Congress for not acting on other smaller cost savings measures which are not within the Postal Service's control." Valpak Reply Comments at 2. It asserts that by not converting, the Postal Service has declined to save between \$2 billion and \$4 billion annually, which it would not do if it were facing a financial crisis and operating in a businesslike manner. *Id.*

Valpak also contests Nickerson's assertion that the cost-cutting measures the Postal Service has taken were responses to the Great Recession. *Id.* at 93. For instance, the Postal Service's proposal to rationalize its network came 4 years after the beginning of the recession, and the POSTPlan was proposed 4.5 years after the recession began. *Id.* at 93-94. Valpak argues that the Postal Service should have "expeditiously and exhaustively" cut costs. *Id.* at 94. Furthermore, Valpak argues, the Postal Service "is fully aware that it could reduce costs further, but it refuses to do so." Valpak Reply Comments at 3.

Valassis argues that it is the Commission's stated position that the Postal Service should not be able to raise rates simply because it demonstrates that it has cut costs. Valassis Comments at 24. Valassis also believes that the Postal Service has not done everything in its power to "cut its unnecessary costs to the bone." *Id.* at 29-30.

The Public Representative argues that a failure to "shed mail volume capacity to adjust to the new normal" would deviate from honest, efficient, and economical management. PR Comments at 17.

b. Commission analysis

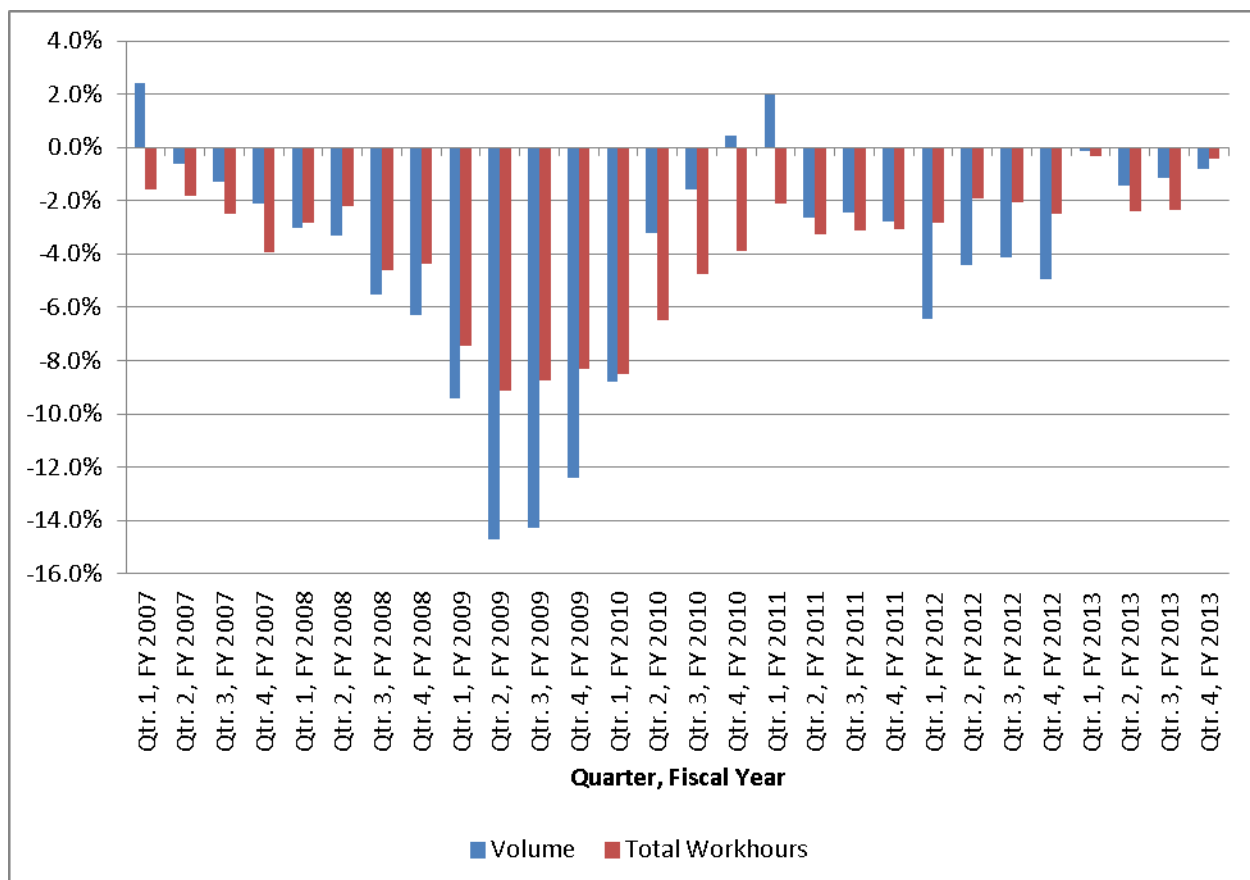
The arguments made by the commenters are not sufficient to persuade the Commission that the Postal Service's management practices have rendered an exigent rate increase unnecessary or less necessary to enable the Postal Service to maintain and continue the development of needed postal services. Even if the Commission found, as the commenters argue, that the Postal Service did not take every available step to cut costs before filing its Request, that fact alone would not be a sufficient basis to deny the Request. Unlike a private enterprise, the Postal Service must consider the impact of its cost-cutting activities on its ability to continue to provide postal services consistent with the policies of title 39, United States Code. Its attempts to cut costs in response to volume declines, regardless of the cause, while complying with the public policy requirements of title 39, United States Code, cannot fairly be characterized as so inconsistent with best practices of honest, efficient, and economical management as to render an exigent rate increase unnecessary or less necessary.

Although commenters have identified additional areas in which cost savings are available, as the Commission found in Order No. 547, "[w]ith respect to Postal Service efforts to cut costs, data suggest that it is making strides over time to cope with volume declines consistent with how the PAEA was intended to function." Order No. 547 at 81. None of the actions described by the commenters is sufficient to alter this conclusion.

In fact, recent data indicate that the positive trends identified in Order No. 547 have continued, albeit at a slower rate. As declines in mail volume have slowed, so has the reduction in workhours. For example, Figure V-1 shows the change in volume and total workhours by quarter from 2007 through the fourth quarter of FY 2013. It shows that, in FY 2011 and FY 2013 (with the exception of the fourth quarter of FY 2013), total workhours were reduced faster than volume has declined.

**Figure V-1**

**Change in Volume and Workhours by Quarter  
FY 2007 – FY 2013**



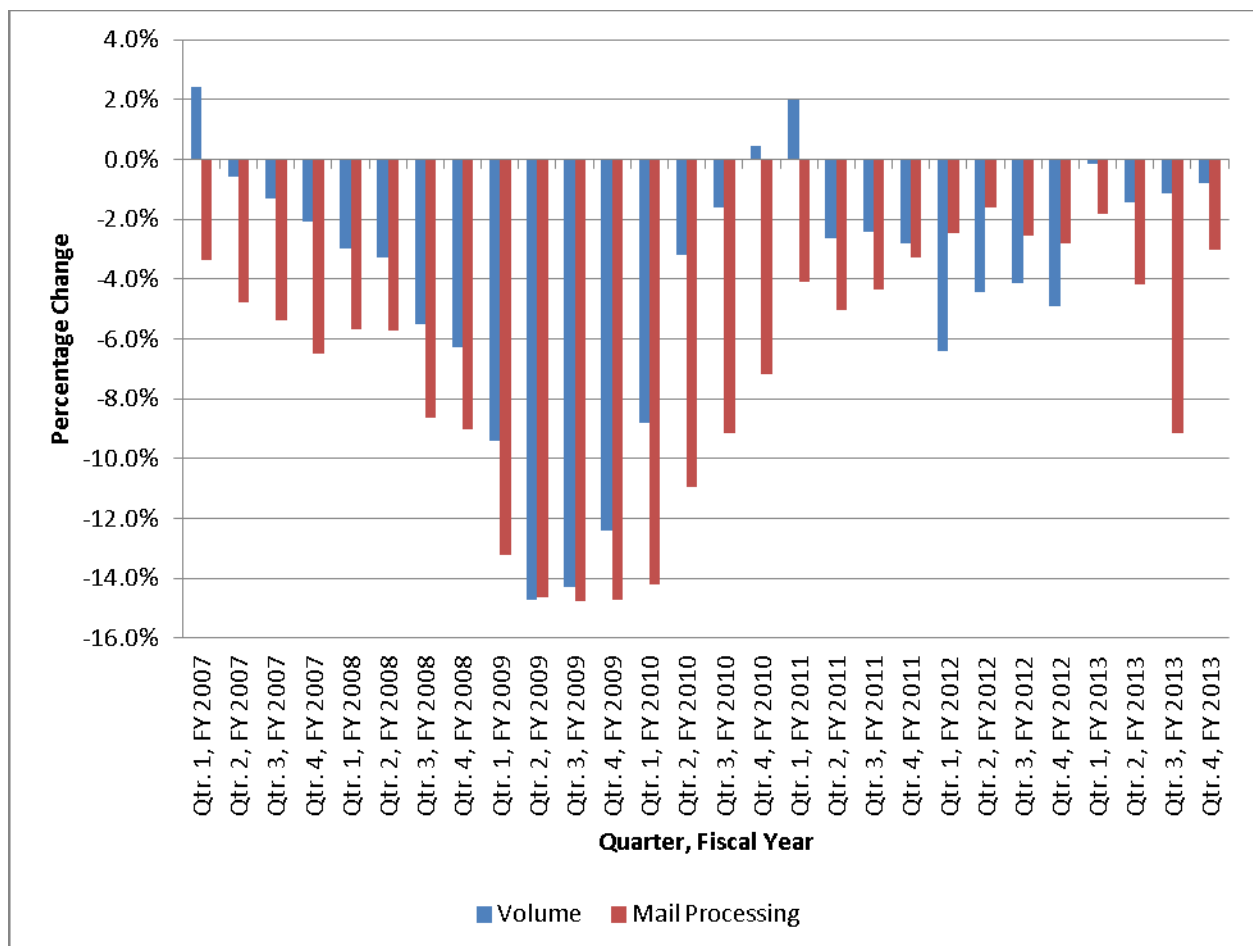
Source: USPS Form 10-Q Quarterly Financial Statements, Quarter 1, FY 2007 – Quarter 4, FY 2013.

Figure V-2, which compares changes in volume and mail processing workhours, demonstrates that reductions in mail processing workhours in FY 2013 were especially dramatic. These data indicate that the Postal Service continues its efforts to adjust its mail processing operations to adapt to volume changes.



**Figure V-2**

**Change in Volume and Mail Processing Workhours by Quarter  
FY 2007 – FY 2013**

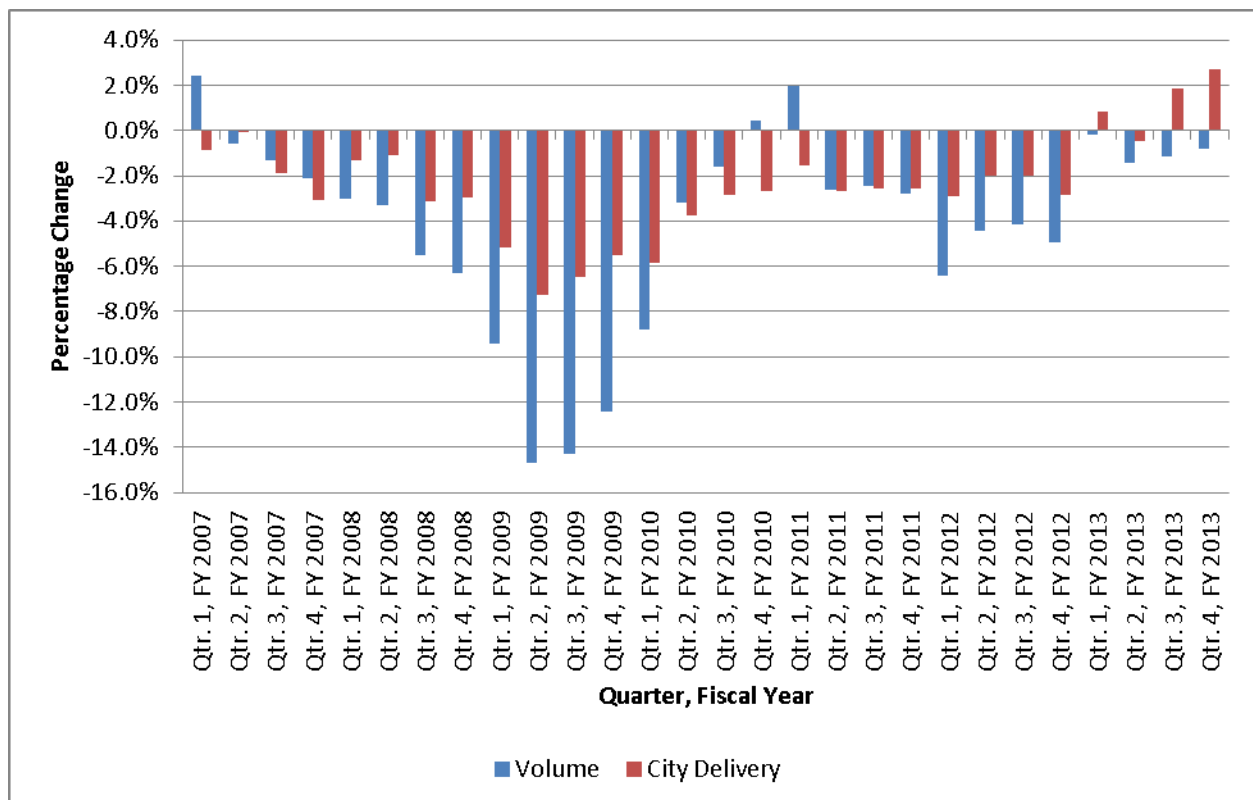


Source: USPS Form 10-Q Quarterly Financial Statements, Quarter 1, FY 2007 – Quarter 4, FY 2013.

Figure V-3 shows the changes in volume compared to city delivery workhours. As the Commission explained in Order No. 547, reducing delivery costs in response to declining volumes is challenging, because “[c]osts associated with the time it takes carriers to walk or drive their route will not change noticeably if mail volumes decline.” Order No. 547 at 84-85. The Postal Service was able to reduce city delivery workhours in FY 2011 and FY 2012 but struggled to do so in FY 2013.

**Figure V-3**

**Change in Volume and City Delivery Workhours by Quarter  
FY 2007 – FY 2013**



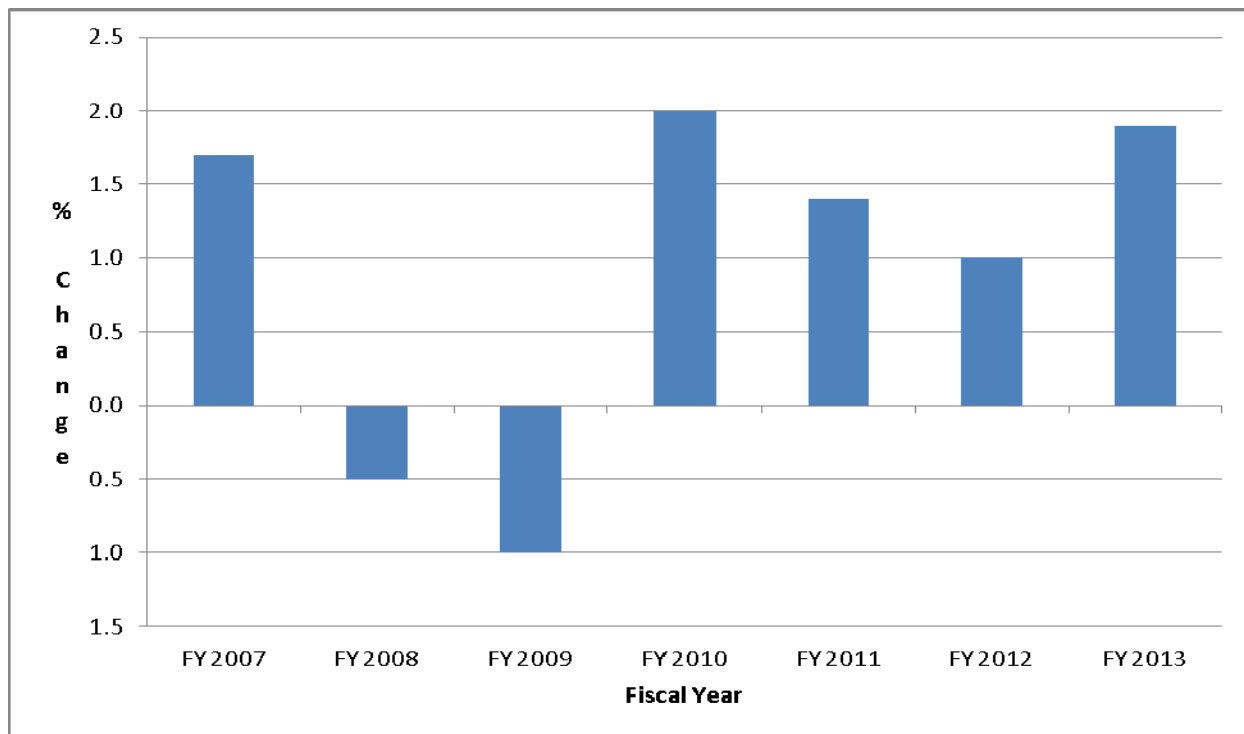
Source: USPS Form 10-Q Quarterly Financial Statements, Quarter 1, FY 2007 – Quarter 4, FY 2013.

Valpak suggests that the Postal Service reduce carrier workhours by converting from door delivery to curbside delivery. Valpak Comments at 95-99. The Postal Service responds that it has made a strategic decision in light of financial, operational, and political considerations not to convert from door delivery at this time to ensure that “any centralized delivery program is ‘adapted to the needs of the United States.’” Postal Service Reply Comments at 105. That further opportunities for cost reductions in this area exist is not sufficient to persuade the Commission that reducing costs in this area would eliminate the need for an exigent rate increase. Although converting from door delivery might reduce costs, Valpak has not shown that converting from door delivery

would also allow the Postal Service to maintain and continue to develop postal services of the kind and quality adapted to the needs of the United States.

Figure V-4 illustrates improvements in Total Factor Productivity (TFP), which measures postal output in relation to input. Although FY 2010 proved to be the recent high water mark for TFP, FY 2011, 2012, and 2013 TFP have been markedly better than FY 2008 and 2009. The Postal Service notes that this is the fourth consecutive year of positive TFP growth. Postal Service Reply Comments at 93. As it did in Order No. 547, the Commission continues to find that improved TFP is “a positive sign as well of the Postal Service’s ability to cut costs over time in response to volume declines.” Order No. 547 at 86.

**Figure V-4**  
**Change in Total Factor Productivity**  
**FY 2007 – FY 2013**



Source: USPS Annual Total Factor Productivity Tables, February 6, 2013, Table 52, FY 2007 – 2012; USPS Form 10-K at 43 – 44, FY 2013.

Finally, the Postal Service has outlined the cost reduction efforts it plans to continue to adjust to declining mail volume. As the Postal Service continues these efforts, it may wish to take into consideration the opportunities for cost savings identified by the commenters in this docket, bearing in mind its responsibility to provide a public service consistent with the requirements of title 39, United States Code. However, past determinations by the Postal Service to forgo cost-cutting opportunities (such as converting from door delivery or reducing the size of the workforce) in order to maintain needed postal services or comply with other legal obligations do not, by themselves, render an exigent rate adjustment unnecessary or less necessary.

### 3. Rate design

#### a. Comments

Some commenters have also argued that the Postal Service's rate design is evidence that it has not used best practices of honest, efficient, and economical management.<sup>120</sup> Valpak contends that the Postal Service "deliberately underprices major products," which it believes demonstrates that the Postal Service is "not operating under 'honest, efficient, and economical management.'" Valpak Comments at 60. It argues that during the Great Recession, "prudently managed private sector firms took aggressive action to reduce losses and maintain liquidity," but the Postal Service did not. *Id.* at 67. It contends that "even now prudent management should be taking much stronger measures to improve the Postal Service's liquidity by reducing losses from underwater products." *Id.* at 68. It concludes that the Postal Service's across-the-board price increase does not satisfy the requirement of "honest, efficient, and economical management." *Id.*

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<sup>120</sup> Commenters have also argued that the Postal Service's rates are unreasonable or inequitable. Those comments are discussed in Chapter VI.

NPPC argues that “[g]ood management does not raise prices to a counter-productive degree, driving away its customers at accelerating rates.” NPPC et al. Comments at 31. It concludes that the rates requested by the Postal Service do not satisfy the requirement that rate adjustments be “reasonable and equitable and necessary under best practices.” *Id.* at 32. In its reply comments, it adds that the Postal Service’s across-the-board increase “hardly evidences a ‘best practice’ of good management[.]” NPPC et al. Reply Comments at 5-6. It argues that the Postal Service’s price elasticity estimates are “essentially meaningless” and that it “is not a best management practice” to raise rates and expect that volume will not decline. *Id.* at 6.

Although Valassis does not specifically argue that the Postal Service’s rate design is evidence of a lack of honest, efficient, and economical management, it suggests that “raising rates substantially above the statutory price caps would be an act of both tactical and strategic weakness and imprudence on the part of Postal Service management.” Valassis Comments at 31.

The Postal Service responds that if “the very act” of filing an exigent request is evidence of imprudent management, the exigent clause would be read out of the statute. Postal Service Reply Comments at 96 n.34. It argues that “the mere tolerance of underwater products ... does not, in and of itself, demonstrate a failure to exercise honest, efficient, and economical management, in light of the various other factors for which management’s reasoned business judgment must account.” *Id.* at 96.

b. Commission analysis

The presence of non-compensatory (underwater) products in the Postal Service’s rate design is not, without more, sufficient to find that the Postal Service’s proposed rate adjustment is unnecessary or less necessary. Since FY 2008, the Commission has identified seven products that have failed to generate revenue sufficient to cover their

attributable costs.<sup>121</sup> However, the Commission “has consistently maintained that a product losing money does not, by itself, necessarily require a finding of non-compliance” with statutory requirements. FY 2012 ACD at 16. Other factors in the Commission’s compliance analysis include: “differences in the circumstances of products showing a loss; the specific reason(s) for the losses; the magnitude and trend of losses; the steps suggested by the Commission to reduce the losses; and the Postal Service’s response to the losses and the Commission’s suggestions for reducing those losses.” *Id.* at 17. Taking those relevant factors into consideration, the Commission “reject[ed] a finding of non-compliance notwithstanding the losses produced by those products.” *Id.*

Furthermore, in the FY 2012 ACD, the Commission found that, with respect to Standard Mail Flats, “under current circumstances, the Postal Service is making reasonable progress” toward addressing issues originally raised in the FY 2010 ACD. *Id.* at 22. With respect to Periodicals, the Commission found that the Postal Service “continues to implement steps to reduce the high costs of processing and delivering Periodicals” and predicted that “[o]perational changes begun in FY 2011 and more fully implemented in FY 2012 may still achieve expected results.” *Id.* at 26. These actions are evidence of efforts by the Postal Service to address cost recovery by underwater products. The Commission fully expects that the Postal Service will continue these efforts. In the meantime, the Postal Service’s pricing choices are not so inconsistent with best practices of honest, efficient, and economical management as to require the Commission to find that an exigent rate increase is unnecessary or less necessary.

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<sup>121</sup> FY 2012 ACD at 15. The seven products are: Inbound International Single-Piece First-Class Mail; Standard Mail Flats; Standard Mail NFMs and Parcels; Periodicals within County; Periodicals Outside County; Single-Piece Parcel Post; and Media and Library Mail. *Id.* n.1.

#### 4. Delay in filing request

Several commenters contend that too much time has elapsed since the end of the Great Recession to allow the Postal Service to use it as the basis of an exigent request. Two commenters go further in arguing that the doctrine of laches prohibits the Request. As the Commission explained in Docket No. R2010-4, the Postal Service's delay in pursuing an exigent rate increase "raises additional questions about whether the Postal Service views its financial situation as an emergency." Order No. 547 at 66. However, because the Commission determined that the exigent request in that docket was not "due to" the recession, it did not reach questions relating to the delay in filing.

The path to the Postal Service's Request has been circuitous. The Postal Service filed the First Exigent Request on July 6, 2010. The Postal Service appealed Order No. 547 and the United States Court of Appeals for the District of Columbia Circuit issued an opinion remanding Order No. 547 in part on May 24, 2011.<sup>122</sup> The Commission established remand procedures on the day the Court issued its mandate, and issued an order on remand on September 20, 2011. Order No. 757; Order No. 864. The order on remand directed the Postal Service to file, no later than October 4, 2011, a statement of whether and how it intended to pursue its exigent request. Order No. 864. Instead of filing this statement, the Postal Service moved to stay proceedings until December 15, 2011, pending legislative developments in Congress.<sup>123</sup> The Commission denied the motion, on the basis that legislative developments were too speculative to warrant a stay, and again gave the Postal Service the opportunity to file a statement declaring its intentions. Order No. 937. The Postal Service filed its statement on November 7, 2011.<sup>124</sup> The Commission found that the Postal Service's statement of its case was

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<sup>122</sup> Petition for Review, *United States Postal Serv. v. Postal Regulatory Comm'n*, 640 F.3d 1263 (D.C. Cir. 2011) (No. 10-1343).

<sup>123</sup> Docket No. R2010-4R, Motion of the United States Postal Service to Stay its Request for Exigent Relief, October 4, 2011 (Motion to Stay).

<sup>124</sup> Docket No. R2010-4R, Statement of the United States Postal Service Regarding its Exigent Request, November 7, 2011.

incomplete and gave the Postal Service the opportunity to submit additional information to complete its request.<sup>125</sup> The Postal Service did not further pursue an above-CPI rate increase until the filing of its Request.

a. Comments

The Postal Service asserts that because it has met all the statutory requirements for an exigent rate increase, the Commission may not dismiss the Request on the basis of the passage of time between the beginning of the Great Recession (or the issuance of Order No. 1059) and the filing of the Request. Request at 39. It argues that, although the statute *allows* the Postal Service to file its request immediately after an extraordinary or exceptional circumstance occurs, it does not *require* immediate filing. *Id.* at 40. It further argues that the Commission is barred from imposing a time limit for filing a request because no such limit is mentioned in 39 U.S.C. § 3622. *Id.* It concedes that there may be circumstances in which the passage of time could prevent an exigent request from meeting statutory requirements (such as the requirement that a rate adjustment be necessary to maintain and continue postal services) but it maintains that such circumstances are not present in this docket. *Id.* at 40-41.

The Postal Service also argues that the Commission's rules do not consider the passage of time before filing to be a relevant factor in evaluating an exigent request. *Id.* at 41. It maintains that references to expedited proceedings in the Commission's rules apply only to action by the Commission and not to the Postal Service's determination about when to pursue an exigent request. *Id.*

The Postal Service urges the Commission to recognize its delay in filing an exigent request as resulting from diligent efforts to avoid an above-CPI rate increase. *Id.* at 42-43. Among these efforts, the Postal Service includes its pursuit of comprehensive postal reform legislation and efforts to reduce costs and increase

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<sup>125</sup> Docket No. R2010-4R, Order Addressing Motion to Supplement and Related Filing, December 20, 2011 (Order No. 1059).



revenues. *Id.* at 43. It acknowledges that the Commission previously declined to stay the exigent request in Docket No. R2010-4R, but argues that this action did not prevent the Postal Service from delaying its response to Order No. 1059 in order to await legislative action. *Id.* at 43; *see also* Order No. 937.

Finally, the Postal Service contends that its delay in filing an exigent request is consistent with the objective of maintaining predictability and stability in rates. Request at 43; *see also* 39 U.S.C. § 3622(b)(2). It argues that its efforts to continue to provide service without increasing rates were an attempt to maintain predictable and stable rates, and that the Postal Service should not now be penalized for trying to avoid an exigent rate increase. *Id.* at 43-44.

Several commenters argue that the Postal Service's delay in filing an exigent request undermines its claim that an exigent rate request is necessary. SMC asserts that the Request should be denied because the Postal Service did not pursue an exigent rate increase on an expedited basis but rather waited 3 years to make its Request. SMC et al. Comments at 3, 6.

ABA argues that waiting 4 years to file a Request is contrary to the intent of Congress and the Commission. ABA Comments at 6-7. It contends that Congress and the Commission intended that an exigent request would follow soon after the emergency that created the need for the request. *Id.* at 7. It asks the Commission to deny the Postal Service's request on the basis that it was not filed soon enough. *Id.*

Valassis argues that the Postal Service's delay in filing its Request effectively de-links the Request from the circumstances on which the Postal Service claims it is based. *See* Valassis Comments at 16-18. Valassis also asserts that the Postal Service's Request is inconsistent on the topic of delay because, although the Postal Service acknowledges that some filing delays could be taken as evidence that necessity has waned, it maintains that its Request does not constitute such a delay given that the

effects of the recession on the Postal Service's financial situation are ongoing. *Id.* at 18 n.8.

b. Commission analysis

The Commission finds no statutory or regulatory basis for concluding that the Postal Service is required to file an exigent request within any specific period of time following the extraordinary or exceptional circumstance upon which the request is based. Section 3622(d)(1)(E) does allow for rates to be adjusted on "an expedited basis." However, the plain language of the provision suggests that it is the Commission's action (the adjustment of rates) which is intended to be expedited, not the Postal Service's reaction to the extraordinary or exceptional circumstance. *Id.* This reading is supported by the fact that the only time limit established in that section is a 90-day limit that applies to the issuance of the Commission's decision. As Valpak notes, 39 U.S.C. § 3622(d)(1)(E) does not contain an express time limitation for Postal Service action. Valpak Reply Comments at 16.

Although neither the statute nor the rules prescribe a specific limitation on the time for the Postal Service's filing, the Commission takes the timing of the Postal Service's request into consideration when determining whether a requested rate adjustment is "necessary" within the meaning of 39 U.S.C. § 3622(d)(1)(E). As the Postal Service and the Public Representative suggest, there could be circumstances in which the Postal Service's delay in filing obviated the need for an exigent request. See Postal Service Request at 40-41; PR Comments at 20.

In this docket, however, the Commission finds that the Postal Service's delay in renewing its exigent request is explained and justified by its desire to avoid piercing the CPI price cap. See Request at 42. The Postal Service cites measures it took to reduce costs without reducing services, including reducing its workforce, workhours, and compensation and benefits, increasing productivity, adjusting the size and nature of its retail network, changing delivery routes, and seeking legislative action. Postal Service

Reply Comments at 91-94. These measures appear to be part of an ongoing good faith effort to improve the Postal Service's financial condition and, consequently, its ability to maintain and continue to develop postal services. Unfortunately, those actions did not entirely alleviate the Postal Service's need for additional liquidity.

Preventing the Postal Service from filing an exigent request on the basis that it first attempted to avoid filing such a request would, perversely, incentivize the Postal Service to seek first to increase its rates instead of or before trying to cut costs. This the Commission will not do.

5. Laches

a. Comments

NPPC contends that the Postal Service is barred by the doctrine of laches from basing a request for exigent rate increases on losses that occurred after September 2010.<sup>126</sup> It believes that the doctrine of laches applies in this docket because the Postal Service is acting in a commercial capacity in seeking to raise rates. *Id.* at 29. It argues that the requirements for application of the doctrine have been fulfilled, because the Postal Service has acted unreasonably in delaying its Request and the delay caused harm to an adverse party. *Id.* at 29-30. It argues that the delay in filing an exigent request is entirely attributable to the Postal Service, which sought judicial review instead of resubmitting its case, requested a further stay of proceedings on remand, and delayed more than 2.5 years between filings in Docket No. R2010-4R. *Id.* at 26-28. Referring to the Postal Service's estimates of steadily declining volume due to the Great Recession, NPPC argues that "[b]y sitting on its right to seek exigent rates, the Postal Service has allowed, under its own theory, the problem to get worse." *Id.* at 29. It

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<sup>126</sup> NPPC et al. Comments at 26. Although NPPC mentions FY 2012 (not September 2010) at this point in its comments, it later contends that the Postal Service may not rely on volume losses that occurred after September 2010. See NPPC et al. Comments at 29, 30. It provides no explanation for the two-year difference, but the reference to FY 2012 appears to be a typographical error.

asserts that mailers have relied to their detriment on the belief that the Postal Service would not file an exigent request. *Id.* at 30; see also SMC et al. Comments at 6-7. NPPC asserts that mailers may have made different decisions about investments in mailing equipment or Full-Service Intelligent Mail barcode software if they had known that the Postal Service planned to request an exigent rate increase. NPPC et al. Comments at 30.

Valpak concurs with NPPC's argument. Valpak Reply Comments at 15. It argues that laches applies to the Postal Service because it "is engaged in a commercial enterprise...and has been commissioned by Congress to be financially self-sufficient[.]" *Id.* Valpak believes that the Postal Service's unique position means that it does "'business on business terms'" and thus is not excepted from the rights and duties of other business enterprises. *Id.* (quoting *Clearfield Trust Co. v. United States*, 318 U.S. 363, 369 (1943)). Valpak adds that the Second and Seventh Circuits have supported the application of the doctrine of laches to government enforcement actions when no express statute of limitations has been established.<sup>127</sup> It argues that since neither section 3622 nor the Commission's order on remand in Docket No. R2010-4R established a time limit for filing an exigent request, the Commission should apply the doctrine of laches to determine that the Postal Service has "unjustifiably delayed action to the detriment of postal patrons[.]" Valpak Reply Comments at 16.

The Postal Service maintains that laches does not apply when it acts on uniquely governmental concerns, in support of the public interest, in the context of an exigent request. Postal Service Reply Comments at 120. It also asserts that sovereign immunity bars the application of the doctrine of laches. *Id.* at 119.

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<sup>127</sup> Valpak Reply Comments at 16, citing *Cayuga Indian Nation of New York v. Pataki*, 413 F.3d 266 (2d Cir. 2005) and *Martin v. Consultants & Adm'rs., Inc.*, 966 F.2d 1078 (7th Cir. 1992).

b. Commission analysis

The doctrine of laches “bars relief to those who delay the assertion of their claims for an unreasonable time.”<sup>128</sup> Delay alone is not sufficient to invoke the doctrine. *Id.* at 138. Because the Commission finds that the Postal Service’s delay in bringing its Request is not unreasonable, the doctrine of laches does not bar the Request.

Additionally, it is an open question whether laches may be invoked against the Postal Service in this context at all. NPPC cites several Seventh and Second Circuit cases for the proposition that laches applies to the Federal Government when it acts in a commercial capacity.<sup>129</sup> However, the D.C. Circuit has emphatically declined to adopt the Seventh Circuit’s laches jurisprudence.<sup>130</sup> Instead, the D.C. Circuit follows what is commonly known as the “*Summerlin* rule,” which provides that laches “is no defense to a suit by [the Government] to enforce a public right or protect a public interest.”<sup>131</sup> This rule is rooted in “the great public policy of preserving the public rights, revenues, and property from injury and loss, by the negligence of public officers.”<sup>132</sup> The D.C. Circuit recognizes a narrow exception to this rule: when the government enters into the market to do “business on business terms.”<sup>133</sup> It is not clear to the Commission that an exigent request constitutes an attempt to do business on business terms. However, because

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<sup>128</sup> *NAACP v. NAACP Legal Def. & Educ. Fund, Inc.*, 753 F.2d 131, 137 (D.C. Cir. 1985).

<sup>129</sup> NPPC et al. Comments at 29, citing *United States v. Admin. Enters., Inc.*, 46 F.3d 670 (7th Cir. 1995); *Cayuga Indian Nation*, 413 F.3d 266; *F.D.I.C. v. Knostman*, 966 F.2d 1133 (7th Cir.1992).

<sup>130</sup> *United States v. Philip Morris, Inc.*, 300 F. Supp. 2d 61, 73 (D.D.C. 2004) (“[T]his is not the Seventh Circuit. *Summerlin*, which has not been overruled by the Supreme Court, remains the law of this Circuit.”).

<sup>131</sup> *Id.* at 72, quoting *Utah Power & Light Co. v. United States*, 243 U.S. 389, 409 (1917). See also *United States v. Summerlin*, 310 U.S. 414, 416 (1940); *United States ex rel. Purcell v. MWI Corp.*, 254 F. Supp. 2d 69 (D.D.C. 2003).

<sup>132</sup> *Philip Morris*, 300 F. Supp. 2d at 72, quoting *Guaranty Trust Co. of New York v. United States*, 304 U.S. 126, 132 (1938) and citing *Ill. Cent. R.R. Co. v. Rogers*, 253 F.2d 349, 353 (D.C. Cir. 1958) and *United States v. California*, 332 U.S. 19, 40 (1947).

<sup>133</sup> *Philip Morris*, 300 F. Supp. 2d at 72, quoting *Clearfield Trust*, 318 U.S. at 369 (finding that the United States as a drawee of commercial paper stands in no different light than any other drawee).

the Commission has found that the Postal Service's delay in bringing its request was not unreasonable, it need not reach the question of whether the doctrine applies.

VI. THE RATES PROPOSED BY THE POSTAL SERVICE SATISFY LEGAL REQUIREMENTS OF REASONABLE AND EQUITABLE

A. Proposed Percentage Increase and Resulting Contribution are Reasonable

1. Witness Nickerson and Witness Taufique

The Postal Service requests a 4.3 percent price increase, forecasted to generate approximately \$1.8 billion in additional contribution.<sup>134</sup> Request at 2. This amount is significantly lower than the Postal Service's estimates of the contribution losses due to volume declines from the Great Recession. The Governors intend the requested 4.3 percent overall price increase in this docket to be complementary to those rate increases requested in Docket No. R2013-10. Tr. 1/64. Together, the increases total 6.0 percent overall and are expected to result in \$2.36 billion in additional contribution. Nickerson Statement at 5.

Nickerson states that the contribution loss resulting from the Great Recession was over \$6.6 billion in FY 2012 alone. *Id.* at 4. The Governors determined that it would not be prudent to request a price increase to replace all of the lost contribution out of concern for the potential adverse effects that such a large increase could have on mailers. *Id.* Instead, the Postal Service proposes to raise market dominant prices by 4.3 percent in conjunction with the price increases within the price cap set forth in Docket No. R2013-10, with the intent of striking a balance between the potential impact of a larger increase on mailers and its need for additional liquidity. *Id.* The Postal Service contends that the overall increase of 6.0 percent will help keep customers in the mail while allowing it to provide its services to mailers. Taufique Statement at 11. Taufique asserts that the exigent increase of 4.3 percent is moderate and reasonable in

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<sup>134</sup> The demand models and forecasts used in the instant docket are based on an update of the econometric demand analysis previously filed with the Commission on January 22, 2013. Nickerson Statement at 15-16.

light of the losses resulting from the Great Recession. *Id.* at 10. The Postal Service intends to continue charging the proposed higher rates for the foreseeable future. Tr. 2/182-83.

## 2. Comments

### a. Initial Comments

ABA, Boardroom, GCA, NPPC, Sacred Heart, Senator Collins, SIIA & ABM, SMC, Valassis, and Valpak challenge the Postal Service's contention that the proposed rates are reasonable.

ABA believes an increase of this magnitude would hurt the Postal Service both in the medium and long term by driving volume to electronic alternatives. ABA Comments at 1-2. It claims that the exigent rate adjustment sought by the Postal Service goes beyond a narrow exception to the CPI cap, bringing uncertainty and unpredictability to the ratemaking process. *Id.* at 5. It criticizes the lack of a defined endpoint for the exigent rate adjustments and the length of time the Postal Service waited after the end of the Great Recession to seek an exigent increase. *Id.* at 6. Finally, it asserts that while an exigent rate increase would provide some revenue offsets to the current losses, the size of the increase and the fact that there is no defined endpoint to the length of the increase could negatively impact mail volume and hurt overall postal operations. *Id.* at 8.

Boardroom explains that its estimate of price elasticity for direct mail is much higher in absolute terms than the Postal Service's own-price elasticity estimates. Boardroom Comments at 3. It contends Standard Mail is highly elastic. *Id.* at 4. Boardroom believes that the Postal Service has not established that its elasticity models predict what will actually happen in the real world, and concludes that the Postal Service will be worse off if any exigent rate is approved. *Id.* at 6.



GCA urges the Commission to consider reasonableness in an “instrumental” sense. Under this definition, a price increase would be reasonable if it would produce more new net revenue than any other treatment of the Postal Service’s prices, or at the least, a revenue increment sufficient to alleviate the deficit appreciably. GCA argues that if increased rates will lead to an actual loss, or to only a trifling increase, it could not be called reasonable. GCA Comments at 21.

In this docket, GCA believes that the exigent rate adjustment may bring in significantly less revenue than anticipated and is therefore unreasonable, in view of other available means of reducing operating deficits. *Id.* at 23. It criticizes the Postal Service’s own-price elasticity estimates for First-Class Mail and states that the Commission should not rely on them. It contends that the exigent rate adjustment will not produce revenue benefits anywhere near those the Postal Service claims for them, and in some cases might actually lead to lost revenue. *Id.* at 24. GCA also submits the Clifton Statement contesting the Postal Service’s own-price elasticity estimates for First-Class Mail.

NPPC argues that giving a 4.3 percent increase to First-Class Mail is not reasonable because (1) it would accelerate diversion further, and (2) the size of the increase exceeds what reasonably can be predicted by its existing estimates of price elasticity of demand. It submits the Buc Declaration to explain that the demand for mail is more elastic than the Postal Service believes. NPPC et al. Comments at 31. The Buc Statement concerns the price elasticity of mail and the effect of the recession on volumes and diversion. It is based on surveys of and discussions with mailers. NPPC asserts that if the requested rates were to take effect, the Postal Service would experience a far greater loss of volume than it appears to expect, likely resulting in a net loss of revenue but inevitably leading to even more dramatic volume declines—and perhaps additional exigency requests—in the future. *Id.* at 32.

Sacred Heart expresses concern that it would have to cut more than one million mailpieces if the exigent rate adjustment is approved. Sacred Heart Comments at 1.

Senator Collins states that raising rates in such a significant manner will drive more customers away from the mail system at an increasingly rapid pace. Senator Collins Comments at 1. She claims that the proposed increases would impose substantial costs on the mailing industry, would hurt small businesses and local newspapers, and undoubtedly, would accelerate further declines in mail volumes and revenues. She predicts the Postal Service will permanently lose business from catalog companies, publishers, and others, and she states that some small newspapers may be forced to completely abandon their relationship with the Postal Service because of the increased costs, coupled with the possible decline in service proposed by the Postal Service. *Id.* at 3.

SIIA & ABM conducted a survey among their members this past summer on how their mailing habits would be affected based on varying postal rate increases. According to their survey, 67 percent of respondents would reduce mailed periodicals by an average of 11 percent if postal rates increased by 7.5 percent. If rates were increased by 10 percent, 90 percent of respondents would reduce mailed periodicals by approximately 13 percent. SIIA & ABM Comments at 2. Although the Postal Service represents that it has accounted for revenue and volume loss as a result of the exigent increase, SIIA & ABM doubt that it has, because its survey indicates that the proposed increase will only drive additional volume and long term revenue from the Postal Service and will cause at least some mailers to constrict their business models. *Id.* at 2-3. They claim that while there may be a short-term increase in revenues, the requested price increase will force mailers in all classes of mail to take action to reduce their postage as well as general business expenses. In the long run, they state that this will reduce, if not eliminate, the additional revenue realized from an exigent increase. *Id.* at 4.

SMC alleges that Saturation Mail is highly price sensitive. An increase in prices above CPI will not produce more revenue for the Postal Service, but will drive out much of this high mark-up, high contribution business. SMC et al. Comments at 3. It adds that a 4.3 percent increase for SMC mailers will not result in anywhere near a

4.3 percent increase in the postage that SMC mailers pay. Instead, contends the increase will lead more highly price sensitive, high contribution mailers to re-evaluate the Postal Service as a reliable provider and to step up their efforts to explore private carrier delivery distribution systems. It maintains that these mailers will cease being profitable customers and will become competitors of the Postal Service. *Id.* at 8.

Valassis states that the Postal Service has been underestimating the price elasticity of its products in general for several years, and that this has been especially so for saturation and advertising mail. Valassis Comments at 7. It characterizes the Postal Service's demand elasticity estimates as "highly questionable" and states that they cannot be used to provide reliable estimates of revenue and contribution generated from the exigent rate adjustment. Valassis argues that mailer demands, especially with respect to advertising mail, have become far more elastic over the recent past—both in the shorter and in the longer term. *Id.* at 31.

Valpak asserts that the Postal Service's rates are not reasonable because its elasticity forecasts are unreliable. It also contends that it is unreasonable that the Postal Service has not waived the right to collect the balance of the losses it claims to have suffered in the Great Recession. Valpak Comments at 85-86.

b. Reply Comments

ABA filed reply comments further expanding on the notion that the adjustments requested are unreasonable. It maintains that a 4.3 percent increase would harm the Postal Service by upsetting the cost-benefit analysis undertaken by mailers and further accelerate electronic diversion. ABA Reply Comments at 2. It also contends the lack of a defined endpoint for the exigent rate adjustments would contravene the reasonableness requirement of the statute. *Id.* at 4.

The Postal Service filed reply comments addressing GCA's and NPPC's contention that the exigent rate adjustments are unreasonable because the adjustments

will generate significantly less revenue and contribution than the Postal Service's models estimate. The Postal Service asserts that whether the exigent rate adjustments earn the forecasted revenue and contribution is not a material consideration in determining whether the Postal Service is entitled to the requested amount of exigent relief. Postal Service Reply Comments at 69. Further, the Postal Service explains that GCA's and NPPC's criticisms of the Postal Service's models are not valid and consequently, the commenters do not have a valid premise for their argument that the proposed price adjustments are unreasonable. *Id.* at 62, 68.

c. The Postal Service's Own-Price Elasticities

As noted above, several commenters assert or imply that the demand for mail is more elastic than what the Postal Service's models estimate. These commenters believe that if the exigent rate adjustment is approved, the Postal Service would lose more mail (and consequently, more revenue) than forecasted by the Postal Service's models. The comments from Buc and Clifton present analyses on why they believe the Postal Service's price elasticity estimates are unrealistic. Clifton and Buc's comments are discussed below.

*Clifton critique.* Clifton discusses the price elasticity estimates for First-Class Mail. He compares the Postal Service's First-Class Mail Single-Piece and Presort price elasticities to estimates from published studies. Clifton Statement at 33. These studies used postal data from the U.S., the UK, France, Finland, or Switzerland. *Id.* at 34. Clifton uses some of these studies to suggest that the Postal Service's demand models should be revised to better account for electronic substitution as a result of price increases, and he asserts that the resulting price elasticity estimates will reflect a higher degree of price sensitivity than the current estimates.

Clifton concludes that the Postal Service's price elasticity estimate for First-Class Mail Single-Piece is a statistical outlier when compared to 12 other studies. *Id.* Clifton asserts that his analysis demonstrates with 99 percent certainty that the price elasticity

for First-Class Single-Piece mail is greater, in absolute terms, than the Postal Service's estimate. *Id.* at 35.

With respect to First-Class Mail Presort, Clifton states that the studies show the Postal Service's estimate is consistent with the other countries (with the exception of Finland, which has higher price elasticities in absolute terms). *Id.* at 37. He notes that studies show that Finland's elasticity estimate differs from the remaining four countries because the Finland data incorporate a cross-price elasticity estimate derived from numerical time series data for electronic substitutes (e-substitutes). *Id.* at 40. He asserts that incorporating such cross-price elasticity estimates results in higher own-price elasticities in absolute terms. *Id.*

Clifton contends that the demand models for First-Class Mail Single-Piece letters should also incorporate cross-price elasticities for e-substitutes. *Id.* He states that these cross-price elasticities must be included in demand models explicitly where data exist or implicitly through simulation where data do not exist. *Id.* He states that when cross-price elasticities have been included in postal demand equations for First-Class letter mail, the own-price elasticities that emerge are substantially more elastic than if they are excluded. *Id.*

*Buc critique.* Buc provides a different rationale for why the Postal Service's own-price elasticity estimates are inaccurate.<sup>135</sup> Buc first states that econometric models may be unreliable for estimating the volume effects of large postal price changes because (1) the structural relationships between mail and important factors (*i.e.*, GDP and employment) appear to be changing and may make mail more or less price elastic; and, (2) there has been minimal variation in real prices under the PAEA. Buc Statement at 5-7.

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<sup>135</sup> NPPC et al. provides its conclusions on Buc's Statement. See NPPC et al. Comments on Buc Statement at 5-6.

In lieu of demand models, Buc discusses the results of surveys and interviews with First-Class Mail and Standard Mail users.<sup>136</sup> *Id.* at 10-19. He represents that the results demonstrate that the demand for mail is likely to be significantly more price elastic than the Postal Service and other recent studies have estimated. *Id.* at 10.

*Thress Replies.* Postal Service witness Thress contests much of what the commenters say regarding the Postal Service's price elasticities, particularly the analyses of Buc and Clifton.<sup>137</sup> Thress states that the price elasticities used by the Postal Service are the best available estimates. Thress Reply Statement at 36.

*Thress' Reply to Clifton.* Thress asserts that the Postal Service's own-price elasticity estimates are consistent with estimates in the studies in Clifton's statement. Thress Reply Statement at 41. Thress contends that the studies presented by Clifton include cross-price elasticities between postal products and therefore are not appropriate for direct comparisons with the Postal Service's estimates. *Id.* at 42, 48. He further states that transforming the price elasticities in the studies to make a proper comparison shows that the Postal Service's estimates are consistent with those in the studies. *Id.* at 44-46.

Thress also addresses Clifton's position that the own-price elasticity of First-Class Mail is inaccurate because of the increasing level of electronic alternatives to the mail. *Id.* at 46. Thress asserts that Clifton's conclusion is the result of a difference in demand model preference. *Id.* He states that by design, Clifton's preferred model will show that price elasticity estimates increase, in absolute terms, as mail volumes decline. *Id.* at 47.

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<sup>136</sup> Buc states that the survey and interviews were conducted by SLS Consulting, Inc. SLS analyzed surveys from 13 First-Class Mail and 14 Standard Mail users, as well as interviews from 6 First-Class Mail and 6 Standard Mail users.

<sup>137</sup> In its reply comments, the Postal Service also addresses Clifton and Buc's critiques of its price elasticity estimates. See Postal Service Reply Comments at 61-62, 68.

*Thress' Reply to Buc.* In response to Buc, Thress notes that econometric estimation is the correct way to estimate price elasticities for this proceeding. *Id.* at 36. He adds that the rate increases being proposed in the case are modest, implying that the increases should not be considered significantly larger than recent changes. *Id.* at 37. He adds that the Postal Service has found no empirical evidence to suggest that elasticities have changed over time. *Id.* at 36-37.

Thress also addresses the surveys and interviews presented by Buc. He points out that Buc concedes that the survey samples are not random, and that the survey results may be biased by the fact that the respondents are large volume mailers. *Id.* at 38-39. Thress concludes that the Postal Service's econometric models should be used over the survey results presented by Buc. *Id.* at 41.

### 3. Commission Analysis

At the outset, the Commission notes that the amount of a "reasonable" request pursuant to section 3622(d)(1)(E) must be evaluated from the perspective of the overall percentage increase in rates requested by the Postal Service as well as the amount of contribution the Postal Service is forecasted to generate.

The Postal Service explains why it needs additional liquidity as a result of the losses resulting from the Great Recession. *See generally* Nickerson Statement. A fair reading of Nickerson's testimony is that the Postal Service would be better off if it had greater liquidity than the amount it is requesting, however, it has recognized that there is a limit on what mailers can bear and adjusted its request to the Commission accordingly. *Id.* at 4.

The Commission concludes that the proposed rates that result from the overall 4.3 percent price increase are reasonable.<sup>138</sup> Based on Thress' forecast model, the Postal Service predicts that it will recover approximately \$1.8 billion in contribution from the exigent rate adjustment. The Commission finds that the Postal Service's model provides the most reliable available estimate of the likely impact on volume of the proposed rate increase.

The Commission finds that Clifton's comparison of the Postal Service's price elasticity estimates with estimates produced in other studies is problematic for several reasons. Clifton used studies that reflect different demand model specifications, assumptions, and for some, postal markets. Each of these has an effect on the own-price elasticity estimates. Also, as the Postal Service points out, most studies analyzed by Clifton include cross-price elasticity estimates for postal products. Once these estimates are taken into consideration, the resulting own-price elasticity estimates from these studies are consistent with the Postal Service's estimates.

The Commission also agrees with Thress that the underlying data reflect an extensive period that includes a significant range of independent variables. The underlying quarterly data range from 1970 to 2013. Although more recent price changes have been clustered close to annual CPI changes, price changes prior to the PAEA include changes larger than 4.3 percent. The Postal Service's own-price elasticity estimates reflect these data.

Buc's survey results indicate that the recent development of technology-based alternatives to mail may increase the potential for volume diversion. However, the results do not provide an adequate alternative to the econometrically calculated Postal Service own-price elasticities. Further, because the surveyed mailers were not selected

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<sup>138</sup> The Commission notes that during this proceeding, the Postal Service revised some billing determinant data underlying the price adjustment workpapers. Consequently, percentage increase figures for some products may have changed from the Postal Service's original filing. However, the proposed rates identified in the Postal Service's Request have not changed.



on the basis of a scientific sample, the results may be biased and no confidence limits can be calculated for any own-price elasticities that are derived from this study. The results from the survey also may be biased because only large mailers were included in the survey. Thus, there is no basis for determining if Buc's own-price elasticity estimates differ in any statistically significant way from the Postal Service's estimates.

Given the problems observed in both Clifton and Buc's analyses, the Commission finds that the Postal Service's own-price elasticity estimates are the best evidence of record. The Commission concludes that it is appropriate for the Governors and the Postal Service to have relied upon these models in designing their rates.

The Commission also evaluates reasonableness based on the overall percentage price increase sought by the Postal Service, including the potential for rate shock. While no commenters assert "rate shock" directly, several commenters suggest that the proposed rate increase would have an adverse effect on users of the mail. Implementing an above-CPI increase in rates without generating adequate contribution to meet the need identified by the Postal Service would raise concerns regarding the reasonableness of the proposed rates.

In the instant docket, the Commission finds that the proposed overall increase of 4.3 percent is unlikely to cause rate shock. While the overall increase exceeds the average rate increases approved in CPI cases, increases well above 4.3 percent for particular products and rate categories are commonplace. As recently as January 27, 2013, the Postal Service implemented rates (approved in Docket No. R2013-1) that increased rates for First-Class Mail Parcels by 5.0 percent and First-Class Mail Non-automation Presort and Mixed ADC Automation flats by 7.5 percent.<sup>139</sup> There is no indication that these increases resulted in serious financial harm to mailers.

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<sup>139</sup> See Order No. 1541, Order on Price Adjustments for Market-Dominant Products and Related Mail Classification Changes, November 16, 2012.

The Commission also determines that the overall increase in rates is consistent with the relevant objectives and factors of 39 U.S.C. §§ 3622(b) and (c). The proposed increase is expected to maintain high quality service pursuant to 3622(b)(2) by providing the Postal Service with the revenue required to continue its obligations under section 3691. It is an acceptable use of the Postal Service's pricing flexibility pursuant to 3622(b)(4) and (c)(7), and it obtains needed liquidity due to the losses from the Great Recession. The resulting contribution from this increase will "assure adequate revenues...to maintain financial stability," allowing the Postal Service to generate higher levels of liquidity to absorb financial adversity and contribute to capital improvements as set forth in section 3622(b)(5). 39 U.S.C § 3622(b)(5). The Commission finds that the increase proposed is also "just and reasonable" as required in section 3622(b)(8). Finally, by proposing a moderate overall price increase and aligning the increase to what mailers could more easily bear, the Postal Service has also taken into account "the effect of rate increases upon the general public, business mail users, and enterprises in the private sector" consistent with section 3622(c)(3).

The Postal Service has made a compelling argument for improving its liquidity and the Commission concludes the overall rate increase and the resulting contribution approved by the Governors are reasonable pursuant to section 3622(d)(1)(E).

**B. Across-the-Board Increases are Equitable**

**1. Witness Taufique**

Taufique explains that the Postal Service has chosen an across-the-board price increase of 4.3 percent for all classes of mail, products within each class (subject to rounding) and, to the extent possible, all price cells within each product. Taufique Statement at 3, 4. The Postal Service states that "[w]ith an exigent circumstance as broad as the recession, the Postal Service believes it is inherently equitable to seek recovery of lost contribution broadly and uniformly, rather than targeting particular classes or products." Request at 35. Taufique adds that "everybody benefits from the

Postal Service remaining in operation so everybody pays an equal share of the burden.” Tr. 1/47-48.

Taufique goes on to identify how the Postal Service’s planned prices help achieve the objectives of section 3622(b) and properly take into account the factors of section 3622(c), both overall and for each class of mail. Taufique Statement at 26-35.

The Postal Service deviates from the across-the-board approach in several instances: (a) to avoid adverse passthrough changes, (b) to maintain dropship discounts across presort levels, and (c) to equalize nonprofit and commercial discounts. Taufique Statement at 4-5. Some variations are also caused by the prices set by the Universal Postal Union (UPU) for First-Class and Package Services International Inbound mail.<sup>140</sup>

*Worksharing.* Taufique testified that one rationale for deviating slightly from the across-the-board price increases for all price cells was to avoid adverse passthrough changes. *Id.* at 4. The Postal Service viewed the passthroughs that resulted from the rates proposed in Docket No. R2013-10 and approved in Order No. 1890 as the original (or baseline) passthroughs. Thus, if the original passthrough for any price cell would increase as a result of a 4.3 percent price increase but remain below 100 percent, then

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<sup>140</sup> The UPU mandated prices were proposed in Docket No. R2013-10, therefore no additional exigent rate adjustments for these products are requested here. *Id.* at 11.

the 4.3 percent increase was maintained. If, however, the 4.3 percent price increase brought any passthrough above 100 percent, the price change was modified to set the passthrough at or below 100 percent.<sup>141</sup>

If the original passthrough was already above 100 percent and the 4.3 percent price increase would have made it even higher, then the price increase was modified to bring the passthrough as close as practicable to the original amount.<sup>142</sup> Finally, if the original

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<sup>141</sup> In its comments, Pitney Bowes identifies an error in the Postal Service's passthrough calculations. Pitney Bowes Comments at 16. In its passthrough calculation for First-Class Mail AADC Letters, the Postal Service calculates the cost avoidance as the avoidable unit cost for Mixed AADC Letters minus a weighted average of the avoidable unit cost of AADC Letters and 3-Digit Letters. The Commission identifies a similar error in the calculation of the passthroughs for First-Class Mail AADC Cards and Standard Mail AADC Letters.

Following the approved Commission methodology, the cost avoidance for the AADC categories is calculated as the avoidable unit cost for the Mixed AADC category minus the avoidable unit cost for the AADC category. See Docket No. RM2012-6, Library References PRC-RM2012-6-LR2 and PRC-RM2012-6-LR3. Using the approved methodology, the passthroughs of First-Class Mail AADC Letters, First-Class Mail AADC Cards and Standard Mail AADC Letters are 111.5 percent, 100 percent and 104.8 percent, respectively. The passthroughs of First-Class Mail AADC Letters and Standard Mail AADC Letters increased from 100.0 percent and 85.7 percent, respectively, in Docket No. R2013-10. The Commission notes that the errors resulted from a methodological change that the Postal Service is applying for the first time. The Commission further notes that the base rates (without the temporary surcharges) are set at or below 100 percent passthrough. Due to the temporary nature of the exigent increase, the Commission does not presently require the alignment of the AADC letter discounts for First-Class Mail and Standard Mail with avoided costs. The Commission expects that the Postal Service will align the discounts with avoided costs when it files its next general market dominant price adjustment, or will adequately support an applicable statutory exception.

<sup>142</sup> In response to POIR No. 6, question 26, the Postal Service acknowledges that it inadvertently deviates from this pricing methodology for the basic presort discounts for Media Mail and Library Mail. In its original workshare discount workpapers filed in this proceeding, the Postal Service transposed the avoided costs of basic and 5-digit presort discounts. Once corrected, the passthrough for Media Mail basic presort increases from 156.7 to 163.3 percent, and the passthrough for Library Mail basic presort increases from 150.0 to 156.7 percent.

The Postal Service explains that its transposition error does not affect the justifications for why these two discounts are in excess of their avoided costs. Further, the Postal Service states that if it aligned these discounts with its pricing methodology, the average price increase for the Media Mail/Library Mail product would be 0.17 percent higher, and the average price increase for other Package Services products would be approximately 0.09 percent lower. Consequently, the Postal Service prefers not to change the proposed Package Services rates for this proceeding, and it requests that the Commission grant this exception from deviating from its pricing methodology.

The Commission grants the Postal Service's request. The Commission recently approved a similar request in Docket No. R2013-10, and both dockets, which were filed contemporaneously, relied on the same workshare discount workpapers. See Order No. 1890 n.125.

passthrough was equal to 100 percent and did not change as a result of the 4.3 percent price increase or if no worksharing relationships were associated with a particular price cell, then the 4.3 percent increase was maintained. *Id.* at 5; Response to POIR No. 11, question 1(f).

*Non-compensatory products (Underwater products).* The Postal Service views its across-the-board price increases as equitable notwithstanding that some products will remain underwater even after the proposed price increases. Taufique Statement at 6. Taufique asserts that the Postal Service “cannot afford to adopt a short-term perspective and take actions that will ‘fix’ a coverage problem by permanently driving mail—mail that [the Postal Service] believe[s] will become profitable as the Postal Service and the mailing community adjust to operational and marketplace realities—or mail that is valued in the mailbox—out of the system.” *Id.*

As with outstanding worksharing issues, the Postal Service intends to address underwater products in the context of future CPI cases. See Tr. 1/16-18. It speaks to concerns about underwater products by explaining that “[t]he 4.3 percent across-the-board price increase will improve cost coverage on (and reduce the ‘cross subsidization’ of) all underwater products and classes. In addition, the underwater products and classes ultimately burden the Postal Service’s aggregate net operating income, cash flow, and liquidity position. This burden therefore was reflected in the 4.3 percent proposal.” Response to POIR No. 11, question 10(a).

## 2. Comments

The following commenters allege that the proposed price increases are not equitable: GCA, NPPC, Pitney Bowes, the Public Representative, SMC, and Valpak. Time Inc. maintains that the proposed rate adjustments are equitable.

a. Initial Comments

GCA states that the proposed prices are not equitable because they do not remedy the allegedly discriminatory price differential between Metered and Stamped First-Class Letters. GCA Comments at 25-27. Specifically, Stamped Letters receive a significantly higher cumulative percentage increase than Metered Letters from Docket Nos. R2013-10 and R2013-11. *Id.*

NPPC argues that, as applied to First-Class Mail, the requested increase is not equitable. It requests that if the Commission approves the exigent price adjustment, it require that the Postal Service adjust passthroughs in First-Class Presort Letters to 100 percent. NPPC et al. Comments at 39.

Pitney Bowes maintains that the proposed price adjustments for First-Class Automation Letters are not equitable. It proposes that to meet these standards, the Postal Service must comply with “normative judgments of fairness.” Pitney Bowes Comments at 6. It draws on the language of PRA section 3622(b)(1) for the proposition that fairness requires each mailer within a subclass pay the costs imposed upon the system plus a uniform per piece contribution (also known as Efficient Component Pricing (ECP) prices). It states that fairness also mandates that worksharing discounts be set at 100 percent, so that workshare and non-workshare mailers provide the same contribution. *Id.* at 6-7. It asserts that because certain workshare discounts are less than avoided costs, the proposed rates are exclusionary and the Postal Service is engaging in anticompetitive behavior. *Id.* at 8, 12. Additionally, it states that the proposed rates are generally inequitable because they result in “exclusionary, unfair, and anticompetitive prices within First-Class Mail Automation Letters.” *Id.* at 13. It urges the Commission to use its authority to modify the proposed rate adjustments for this product so that discounts will not be set at less than 100 percent of avoided costs. *Id.* at 15.

The Public Representative maintains that the proposed prices are generally reasonable and equitable except for those prices that do not cover costs and fail to correct inefficient workshare discounts. PR Comments at 40. The Public Representative states that it is not equitable to cause mailers of profitable products to subsidize users of underwater products even after an exigent rate adjustment. He also states that it is imprudent for the Postal Service to offer worksharing discounts that deviate significantly from 100 percent passthrough because these discounts do not send appropriate pricing signals. *Id.* at 39. He recommends that the Commission adjust the proposed prices to ensure unprofitable products—such as Standard Mail Flats, In-County Periodicals, and Outside County Periodicals—receive larger increases than profitable products. *Id.* at 44-46. He asserts that because there are no cost reductions planned for Standard Mail Flats, a larger price increase than what the Postal Service proposes is warranted. *Id.* at 45. The Public Representative “recommends that the price increase for Standard Mail Flats be (at a minimum) 1.05 times the overall proposed price increase of 4.3 percent.” *Id.* He also urges the Commission to adjust inefficient worksharing discounts to send the appropriate price signals to mailers. *Id.* at 46.

SMC claims that the proposed rates will have an adverse and disproportionate impact on small businesses and local advertisers. SMC Comments at 3. SMC urges the Commission to reject the Postal Service’s request. *Id.* at 13.

Valpak states that the rates are inequitable because they “impose a further burden on those mailers who have been and are already carrying the burden of the Postal Service’s institutional costs.” It asserts that the proposed rates “perpetuate an inequitable and unreasonable rate structure which unfairly discriminates against some and unfairly subsidize[s] others.” Valpak Comments at 86. It highlights Standard Mail Flats and Periodicals rates as examples of products that require subsidization from other mail users. *Id.* at 87.

b. Reply Comments

GCA responds to the comments of NPPC and Pitney Bowes calling for increased discounts in presort mail and the redesign of presort rates, respectively. It asserts that such issues are better left for the Commission to review in its Annual Compliance Determination. GCA Reply Comments at 20-21.

MPA takes issue with the recommendation to impose above-average rate increases on Standard Mail Flats and Periodicals. It states that the Commission would not be justified in imposing above-average increases for Periodicals and Standard Mail Flats in this proceeding because the record does not support a disproportionate increase. MPA et al. Reply Comments at 3-4. It suggests these products have been underwater for many years, and there is “nothing extraordinary or exceptional about” their underwater status. If anything, the only effect of the Great Recession would have been a lessening of Postal Service’s losses by the recession-induced reduction in the volume of these products. *Id.* at 4.

MPA argues that the “due to” provision of section 3622(d)(1)(E) limits rate increases to recovery of only those losses caused by the exceptional or extraordinary circumstance, in this case, the Great Recession. *Id.* at 7. It claims that the price cap is the only protection that market-dominant mailers have from excessive price increases and “[e]xpanding the exigency provision from a limited escape valve into an all-purpose vehicle for recovering losses of all kinds would leave captive mailers without any effective protection at all.” *Id.* at 8. Finally, it states that such above-average increases would be ill-advised because they would be likely to decrease the Postal Service’s net contribution in the long run. *Id.* at 22.

NPPC reiterates its opposition to the across-the-board price increases, stating that the Postal Service made “no attempt to consider, and certainly no attempt to prove, what prices would be appropriate for its most profitable products, how discounts could send more efficient signals, or even to determine how its customers would likely



respond.” NPPC et al. Reply Comments at 5. It adopts Pitney Bowes’ recommendation that, in the event the price increases in this docket are approved, the Commission should set worksharing discounts equal to avoided costs and the Full Service Intelligent Mail barcode discount should be increased to keep the changes revenue neutral. *Id.* at 7.

The Postal Service maintains that its approach is equitable because it “(1) avoid[s] discrimination and undue disruption to mailers, (2) improv[es] the cost coverage of underwater products, and (3) ensur[es] that no workshare passthroughs increase further above 100 percent...while also allowing workshare passthroughs below 100 percent to increase.” Postal Service Reply Comments at 109. It claims that an exigent rate adjustment is not the appropriate mechanism for correcting pricing concerns unrelated to the harm caused by the Great Recession. *Id.* at 110. It criticizes Valpak’s comments, in particular, as conflating negative contribution from underwater products with losses related to the Great Recession. *Id.* at 113.

Time Inc. maintains that the across-the-board pricing approach demonstrates a thoughtful balancing of the various factors that must be taken into account in an exigent request. It argues that Taufique has made a persuasive argument against differentiated rate increases in this proceeding. Time Inc. Reply Comments at 16-17. It states that larger increases for products that experienced the largest volume declines during the Great Recession would lead to inequitable results and bad market strategy for the Postal Service. *Id.* at 17.

Valpak again urges the Commission to reject the Postal Service’s across-the-board pricing approach, because “it was made without regard to the opportunity in this docket to use ‘pricing flexibility’ to maximize contribution by ‘highly differentiated’ price changes.” As such, Valpak views the Governors’ decision as a failure to act in an informed manner. Valpak Comments at 5. It also criticizes the Public Representative’s proposal to increase the Standard Mail Flats product to, at a minimum, 1.05 times the

overall price increase as a mere “baby step” in eliminating negative contribution. *Id.* at 12.

### 3. Commission Analysis

As with the analyses of reasonableness and necessity, considerations of equity must be made on a case-by-case basis in the context of all relevant circumstances. In the instant case, relevant factors include the concurrent increases proposed in Docket No. R2013-10, which address rate design issues, as well as the temporary nature of the exigent rate adjustments. Consistent with that, the Commission observes that under other circumstances, differentiated price increases may be warranted under section 3622(d)(1)(E).

Here, the Commission determines that the Postal Service’s across-the-board pricing strategy is equitable. Each class of mail is increased by approximately 4.3 percent. Rule 3010.61(a)(3) requires that the Postal Service demonstrate to the Commission how the specific rate adjustments requested relate to the extraordinary or exceptional circumstances claimed. The Postal Service has made a sufficient showing that the particular circumstances surrounding the Great Recession do not necessitate differentiated price increases for various classes of mail.

Commenters have alleged that the rates resulting from the Postal Service’s across-the-board approach are inequitable. They assert differentiated rate increases reflecting considerations such as product cost coverage, price elasticity and ECP pricing are necessary to produce the optimal pricing outcome for each product. However, the statute does not require the Postal Service to produce an optimal pricing result in the face of extraordinary or exceptional circumstances, but rather prices that are equitable.

The Postal Service asserts that the Request “was not meant to fix all the real and perceived problems in rate relationships, cost coverages, or passthroughs. The principal purpose of this filing was to recover some of the contribution lost because of

unprecedented volume declines caused by the Great Recession.” See Response to POIR No. 11, question 2(b). It has represented to the Commission that these other issues will be addressed, going forward, in future CPI cases. See Tr. 1/17.

Valpak specifically challenges the Postal Service’s rate design by stating that it fails to meet several of the objectives and factors of 39 U.S.C. § 3622(b) and (c).<sup>143</sup> Valpak argues that the rates do not “maximize incentives to reduce costs and increase efficiency” pursuant to section 3622(b)(1). Instead, Valpak contends the rates continue to send erroneous pricing signals to mailers. Valpak Comments at 88. It also argues that the exigent request does not “create predictability and stability in rates” as required by section 3622(b)(2) by raising rates above the cap. It asserts that an across-the-board price increase is the antithesis of “pricing flexibility” granted to the Postal Service in sections 3622(b)(4) and (c)(7) and the proposed prices do not result in a “just and reasonable schedule for rates” under section 3622(b)(8) because they retain existing cross subsidies. It claims that cross-subsidization does not create rates that “reflect the value of mail service actually provided to each class” as provided in section 3622(c)(1) and the continued existence of underwater Periodicals violates “the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service...” in section 3622(c)(2). *Id.*

The pricing provisions in section 3622 are at times competing. The objectives include stability in rates, assuring adequate revenues, Postal Service pricing flexibility, and increasing efficiency. The factors include rate impacts, cost attribution, the value of the mail, simplicity of the rate structure, and educational value to the recipient. Upon review of the relevant objectives and factors, the Commission finds that the balance of considerations supports the Postal Service’s approach.

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<sup>143</sup> Although Valpak frames this criticism as a challenge to the “reasonableness” of the proposed rates, the Commission evaluates it under the equitable prong because it concerns the across-the-board nature of the price increases.

An across-the-board approach maintains predictability and stability in rates pursuant to 3622(b)(2) by tempering the effects of an exigent rate adjustment, spreading the percentage increase equally over all classes of mail instead of giving disproportionate increases. Because of the temporary nature of the proposed rates, products given significantly higher increases would experience large fluctuations in rates.

Sections 3622(b)(4) and (c)(7) afford the Postal Service pricing flexibility to design rates that balance its own needs with the operational realities of the mailing communities it serves. Moreover, the Postal Service acknowledges the need to continue to address rate design issues in future CPI cases. The Postal Service's representation is an important consideration in the Commission finding that the across-the-board approach is equitable.

The instant request contributes to the "transparency of the ratemaking process" under section 3622(b)(6) by allowing a more involved process for stakeholders to be made aware of and provide input on rates than the typical price cap docket. In this docket, interested persons were provided with the ability to propose questions for the Postal Service witnesses at technical conferences and hearings in addition to the opportunity to provide written and reply comments. Finally, the across-the-board approach also provides a "simplicity of structure for the entire schedule" pursuant to 3622(c)(6).

The Commission does not discount commenters' concern about non-compensatory products and passthroughs set below 100 percent.<sup>144</sup> However, as Time

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<sup>144</sup> The Commission's consideration of the equitable requirement of section 3622(d)(1)(E) arises only after the due to and necessary requirements have been addressed. In this proceeding, the Postal Service proposes to roll the exigent rate adjustment into the base rates and recover that amount indefinitely, perhaps permanently. Under that proposal, as opposed to the limited-term increase approved by the Commission, it might be more appropriate to view resolution of lingering and pre-existing pricing issues more holistically. The temporary rates (in the form of a surcharge) will be in place for a relatively short time, which militates against differential pricing that would cause some mailers to experience wide fluctuations in price. See 39 U.S.C. §§ 3622(b)(2), (c)(3).

Inc. and MPA observe, these issues are not “due to” the Great Recession. The Postal Service has made an effort not to exacerbate existing problems in underwater products and passthroughs, improving the cost coverage of underwater products and avoiding increasing passthroughs that are over 100 percent. It has chosen not to target certain products or “punish the survivors.” Tr. 1/14, 48. This approach, while not the only potentially equitable pricing strategy the Postal Service could have undertaken, falls within the range of equitable methods acceptable for recovering losses due to the Great Recession. The Commission finds that the temporary nature of the proposed rates mitigates ill effects on mailers as a whole.

The across-the-board increase proposed in this docket achieves the various objectives of section 3622(b) while taking into account the factors listed in section 3622(c). On balance, the Commission concludes that an across-the-board increase is equitable, serving the interest of mailers, the Postal Service, and the public generally.

## VII. THE APPROPRIATE DURATION OF THE EXIGENT RATE ADJUSTMENT AND THE MECHANISM FOR COLLECTION

In Chapter IV, the Commission finds that the Postal Service has experienced financial harm due to the Great Recession and is legally entitled to implement price increases in excess of the CPI cap. Based on the record before it, the Commission finds that the Postal Service has not justified a volume loss of 53.5 billion pieces in FY 2012. The Commission calculates a maximum total volume loss of 25.3 billion pieces related to the Great Recession.<sup>145</sup> However, the Commission has also determined that the financial harm “due to” the Great Recession should be limited to the financial harm due to that extraordinary and exceptional circumstance. This Chapter discusses the appropriate duration for collection of the exigent rate adjustment and details the mechanism the Commission will, in the absence of an acceptable alternate proposal from the Postal Service, use to ensure that that Postal Service does not increase prices above the amount allowed by the extraordinary and exceptional circumstance.

### A. Duration of the Exigent Rate Adjustment

Approval of an exigent rate adjustment requires consideration of the appropriate period of time over which the Postal Service should be authorized to collect the adjustment.

#### 1. Commenter Positions

ABA, FSR & NAMIC, MPA, and NPPC oppose on various grounds the open-ended nature of the Postal Service’s Request. ABA and MPA argue that the failure to

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<sup>145</sup> As detailed in Chapter IV, the mail losses for each class are calculated as the maximum cumulative effect of recession-related factors on mail volumes for the particular class of mail. The corresponding time point indicates the beginning of the “new normal.” For each class of mail, volume losses occurring after such time have not been shown to be the result of the Great Recession. The endpoint occurs between 2009 and 2011, depending upon the class of mail.

include a defined endpoint for the proposed exigent rate increase violates section 3010.61(a)(6) and requires denial of the Postal Service's Request. ABA Comments at 7; MPA et al. Comments at 50-52. ABA asserts further that the absence of a defined endpoint creates uncertainty for mailers that will further accelerate the adoption of electronic means of communication "at the expense of postal services." ABA Comments at 7.

Several commenters assert that the absence of an endpoint will produce a massive over-recovery. *E.g.*, FSR & NAMIC Comments at 5; MPA et al. Comments at 49-50; NPPC et al. Comments at 11. MPA claims that such a result would violate section 3622(d)(1)(E) by permitting the Postal Service to recover losses that could not possibly be regarded as "due to" the 2007-2009 recession; by permitting the recovery of losses not shown to be "necessary" for continued operation of the Postal Service; and by violating the requirement that exigent rate adjustments be "reasonable and equitable." MPA et al. Comments at 50. FSR & NAMIC allege that the open-ended recovery proposed by the Postal Service would violate a basic principle that relief "must fit the issue justifying relief." FSR & NAMIC Comments at 5.

ABA and FSR & NAMIC assert further that collection of the requested exigent rate adjustments would undermine the integrity of the price cap. ABA Comments at 7; FSR & NAMIC Comments at 5-6. For these and other reasons, ABA and FSR & NAMIC urge the Commission to deny the proposed rate adjustments. ABA Comments at 7; FSR & NAMIC Comments at 17. *See also* NPPC et al. Comments at 40.

By contrast, MPA urges the Commission to limit the price increases proposed by the Postal Service. MPA et al. Comments at 57. In particular, MPA argues that the Postal Service must be forced to adjust to the "new normal" by limiting the duration and amount of any exigent rate adjustments allowed in this docket to a maximum duration of 24 months and a contribution increase of approximately \$351 million per year. MPA et al. Comments at 52-53.

## 2. Postal Service Response

The Postal Service opposes the denial of its exigent rate request. Postal Service Reply Comments at 114-15. First, it asserts that it has complied with section 3010.61(a)(6) by explaining how long it proposes to keep the exigent increase in effect. *Id.* at 115. It points to the fact that section 3010.61(a)(6) does not expressly require it to state with certainty at the time it files its request what the definitive endpoint will be. *Id.* Nor, it asserts, is there any requirement that an exigent increase be short-term in duration. *Id.* It bolsters its position further by noting the Commission's statement at page 68 of the preamble to Order No. 43 (the order adopting the rules for exigent rate adjustments) that the PAEA does not include a requirement that exigent rate adjustments be temporary. *Id.* Finally, the Postal Service notes that Order No. 547 at 67-68 stated that exigent rate adjustments "ordinarily should be relatively short-lived," but that this might not always be the case. *Id.* at 115 n.45.

With respect to the exigent rate adjustments themselves, the Postal Service takes the position that "this increase should remain in the rate base until its continuation is no longer consistent with the language of the exigency clause." *Id.* at 115. By that, it means that the alleged ongoing "effects of the recession might end, or be diminished to the point that the modest increase proposed in this Request would exceed the continuing impacts of the recession." *Id.* In such event, the increase would be rolled back entirely, or reduced in size, "consistent with the dictates of the 'due to' clause." *Id.* If, on the other hand, the volume lost "due to" the Great Recession does not return, the Postal Service claims that it should be entitled to continued collection of the exigent increases. *Id.*

The Postal Service suggests that collection of the exigent increases could be terminated if, at some point, those increases are no longer "necessary." *Id.* at 116. Having raised this latter possibility, the Postal Service adds that it is unlikely that the increase would become "unnecessary" until such time as legislation is enacted that (1) enables the Postal Service to reduce its labor costs; and (2) enables the Postal



Service to reduce network costs by “redefining the contours of [the universal service] obligation and [service] standards.” *Id.* In a footnote, the Postal Service cautions that “the mere passage of legislation would not, of course, necessarily mean that the continuation of this increase, in whole or in part, is no longer ‘necessary.’” *Id.* n.46.

With respect to the price cap, the Postal Service claims that it would not be undermined by the proposed open-ended exigent rate adjustments. *See id.* at 117. It claims that the incentives of the price cap would continue in force because of the threat the Commission might at some point find the Postal Service was not exercising “honest, efficient, and economical management,” thereby leading to rescission by the Commission of the exigent rate adjustments on the grounds that they are no longer “necessary.” *Id.* Moreover, the Postal Service alleges that its “poor financial shape” and “a very challenging marketplace” would continue to provide it incentives to improve its performance. *Id.*

The Postal Service opposes MPA’s suggestion that limits of 24 months and \$351 million per year should be placed on any exigent relief authorized by the Commission. *Id.* n.47. It alleges that such limits are “wholly divorced from the language of the statute[.]” *Id.*

The Postal Service asserts that the harm of the Great Recession is ongoing<sup>146</sup> and does not foresee a change in circumstances that would lead to removal of the surcharge. In its Reply Comments, the Postal Service elucidates:

Fundamentally, the duration of an exigent increase should be based on whether that increase remains consistent with the statute. At this point in time, how long these proposed increases may be consistent with the statute cannot be predicted with certainty. But, the Commission has ample authority to monitor whether these increases continue to be consistent with the statute, and to rescind them in

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<sup>146</sup> As stated by witness Nickerson, the “loss of volume in 2008 and 2009 is ongoing.” Tr. 2/186.

whole or in part when they deem that doing so is appropriate under the statute.

Postal Service Reply Comments at 114.

### 3. Commission Analysis

*Compliance with 39 C.F.R. 3010.61(a)(6).* Arguments by ABA and MPA that the Postal Service's Request should be denied for failure to comply with section 3010.61(a)(6) of the Commission's regulations are rejected. As the Postal Service correctly points out, neither 39 U.S.C. 3622(d)(1)(E) nor 39 C.F.R. 3010.61(a)(6) requires it to identify with certainty, at the time it files its exigent request, a definitive endpoint for collection of exigent rate adjustments. The Postal Service's description of the circumstances under which collection of exigent adjustments could end is adequate compliance with section 3010.61(a)(6) for purposes of considering its Request.

*Indefinite collection of exigent rate increases.* As proposed, the Postal Service's rate adjustments would remain in effect unless and until either the Commission ordered their rescission or Congress passed legislation, which the Postal Service, in its sole discretion, deemed acceptable. Postal Service Reply Comments at 114-18. With regard to the former, the Postal Service would expect the Commission to develop a record demonstrating that the requirements of either the "due to" clause or "necessary" requirement mandated rescission of the exigent adjustments. *See id.* at 115-17. Alternatively, the Postal Service would require the Commission to make a finding that the Postal Service had failed to exercise "best practices of honest, effective, and economical management" before it could order rescission.<sup>147</sup>

The Commission rejects the Postal Service's proposal to collect an exigent rate adjustment indefinitely. Such a proposal is inconsistent with the fundamental policies

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<sup>147</sup> *See id.* at 117. Given the disposition of the Request in this Order, the Commission finds it unnecessary to address the merits of these arguments other than to note that under the Postal Service's interpretation, the burden of proof that it is entitled to recover the exigent rate adjustment indefinitely would be inappropriately shifted to ratepayers.

underlying the PAEA. Although section 3622(d)(1)(E) does not expressly provide for the imposition of a deadline on collection of an exigent rate adjustment, neither does it expressly authorize indefinite collection of such an adjustment. In such circumstances, the Commission must look to the structure and underlying policies of the statute for guidance.

Under the PAEA, the price cap was to operate in situations in which postal volumes were rising, as well as situations in which postal volumes were declining. In an environment in which volumes are declining, the price cap does not contain a mechanism whereby lost contribution can generally and routinely be recouped by the Postal Service. In such an environment, the Postal Service is expected to respond to the declining volumes by reducing costs and improving efficiencies.

Section 3622(d)(1)(E) provides a special limited exception that permits the Postal Service to pierce the price cap in order to recover amounts properly demonstrated to be “due to” either “extraordinary or exceptional circumstances.” It does not, however, suspend or eliminate the Postal Service’s obligation to respond to revenue losses by reducing costs or improving efficiency. It is this continuing obligation of the Postal Service to improve its financial and operating performance, an obligation at the heart of the PAEA, that requires the Commission to determine an appropriate end date for collection of an exigent rate adjustment. While the Postal Service remains free to propose, as it has in this case, a longer term, or even indefinite, rate adjustment, it must sustain the burden of demonstrating why such collection is not precluded by the fundamental policies of the PAEA, including, in particular, the policy of fostering cost reductions and greater efficiency. For the reasons discussed below, the Commission concludes that the Postal Service has not adequately supported its request that an exigent rate adjustment be collected for an indefinite period.

The NBER found that the Great Recession ended in June 2009. While the impact, measured by macroeconomic variables, did not necessarily end at that point, the Postal Service has been adjusting its network in light of the continuing volume

losses. Indeed, it began downsizing its network to meet the workload associated with the substantially lower volumes it has experienced since 2007, including taking steps in response to the Great Recession:

I believe the Postal Service has addressed, as you put it, the new normal by reducing employee complement, consolidating mail processing facilities, reducing retail hours, all these cost reduction activities to adjust to what mail volume is now and what is anticipated to be in the future... the Postal Service had built in infrastructure to service 200 billion pieces of mail when that was the old normal and we have had to make these really significant adjustments in a relatively short period of time to ratchet everything down.

Tr. 2/198-99 (Testimony of Postal Service Witness Stephen J. Nickerson in response to question by Chairman Goldway). The Postal Service will also have additional time to right-size its network while the exigent rate is in effect.

The Commission observes that First-Class Mail volume had begun decreasing before the Great Recession.<sup>148</sup> This is particularly problematic for the Postal Service because the mail processing and delivery networks have developed, in large part, to accommodate First-Class Mail volumes. In Docket No. N2012-1 the Postal Service stated:

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<sup>148</sup> In its FY 2006 annual report the Postal Service states:

First-Class Mail volume, our largest mail class until 2005, decreased slightly in 2006, declining for the third time in the last four years. An increase of 1,075 million pieces or 2.1% in workshare First-Class letters partially offset the continuing decline in single-piece volume, which was down 1,529 million pieces or 3.3%. The long-term continued decline in single-piece volume reflects the impact of electronic diversion as businesses, nonprofit organizations, governments, and households increasingly automate transactions and divert correspondence to the Internet.

United States Postal Service, Annual Report 2006 (2006) at 26, available at <http://about.usps.com/who-we-are/financials/annual-reports/fy2006.pdf>.

The current postal processing and transportation infrastructure was developed over previous decades to handle significantly more First-Class Mail volume than currently exists today. Unfortunately, in recent years the Postal Service has experienced steady and precipitous declines in mail volume, driven largely by the accelerated diversion of First-Class Mail to electronic media. While a recovery from the worst of the recent economic recession may slow the rate of decline, postal customers' increasing use of electronic communication ensures that this downward trend will to [sic] continue into the foreseeable future.<sup>149</sup>

According to the Postal Service, Standard Mail volume also began to deviate from historical growth patterns prior to the Great Recession:

Now, for standard regular mail, there was a weakening of the relationship with the economy back in 2006-2007. There was a major bottoming out in 2008-2009, but that bottom -- but we sort of reached the bottom there. And so to some extent I think it's fair to call maybe 2010 through 2013 the new normal for standard mail.

Tr. 1/119 (Testimony of Postal Service Witness Thomas E. Thress in response to question by Chairman Goldway).

The Postal Service's own consultants, the Boston Consulting Group (BCG), forecasted much lower volumes in the future.<sup>150</sup> The prospect of substantial volume losses prompted the Postal Service to devise a plan to reduce costs to remain solvent.

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<sup>149</sup> Docket No. N2012-1, Brief of the United States Postal Service, July 10, 2012, at 1-2 (Postal Service Initial Brief).

<sup>150</sup> The BCG Volume Report, dated March 2, 2010, can be found at <http://about.usps.com/future-postal-service/bcg-detailedpresentation.pdf>. It details BCG's projection that overall volume will likely be between 118 and 150 billion pieces in FY 2020. See slide 8. See also the Postal Service's FY 2009 Integrated Financial Plan (November, 2008) at 3 (4 percent volume decline reported for 2009); Postal Service Form 10-K for Fiscal Year 2008 at 26 (projected 3-4 percent volume decline for 2009); Postal Service Form 10-K for Fiscal Year 2009 at 29 (project 6-9 percent volume decrease for 2010); and Postal Service Form 10-K for Fiscal Year 2010 at 3 (volume projected to be virtually flat for 2011).

The Postal Service has been downsizing its network to align it with much lower volumes. The process of right-sizing the Postal Service's network to handle projected lower volumes in an efficient manner is a continuing process. It appears the Postal Service was on a path before the Great Recession that would allow it to efficiently handle lower volume. The effect of the Great Recession was to accelerate the loss of volume and therefore the need to downsize more quickly. With or without the Great Recession, the Postal Service was forecasted to lose the 25 billion pieces identified above. However, the Great Recession caused an extraordinary and rapid reduction that could not be dealt with effectively. The losses from that extraordinary event are recoverable.

However, the Commission concludes that, on the facts presented, the financial harm attributable to the Great Recession cannot be found to extend indefinitely. The Postal Service should be allowed to recover the lost contribution one time. It has not justified recovery of its losses repeatedly, through permanent incorporation of the recovery into the rates.

#### B. Collection Mechanism

The Commission must also address the mechanism for assuring that the rates approved in this Order collect the amount authorized.

##### 1. Commenter Positions

The Public Representative, Valpak, and GCA suggest treating the exigent rate adjustment as a surcharge, and propose mechanisms for limiting the duration of such a surcharge consistent with the statute.

The Public Representative proposes that "any exigent price increase approved by the Commission be administered as a price surcharge added to the prices approved in Docket No. R2013-10." PR Comments at 22. The Public Representative adds that

the “surcharge price table would remain in effect until the Postal Service recoups the fixed contribution the Commission approves due to the exigency.” *Id.* at 23.

In its Reply Comments, Valpak states that the surcharge price table proposed by the Public Representative “is a good idea and would ameliorate part of the serious problem identified by MPA, *et al.* regarding the compounding effect of basing future price adjustments on exigent prices[.]” Valpak Reply Comments at 13. Regarding the negative CPI banked authority in several market dominant classes, Valpak states that:

The PR’s proposed surcharge table could work, but only if the base prices were readjusted to account for the current negative unused rate adjustment authority. For example, base prices for Standard Mail would be the price approved in Docket No. R2013-10 minus 0.354 percent, with the surcharge prices being equal to 4.618 percent....

*Id.* at 14. The Commission addresses Valpak’s argument regarding the negative bank in Chapter VIII.

In its Reply Comments, GCA notes that a surcharge mechanism “would make any exigency increase more likely to pass the reasonableness test[.]” GCA Reply Comments at 27. Further, GCA states:

Once the Commission quantifies the financial impact of the exigency, the recovery target is not a certain number of cents per piece or a certain percentage increase in rates; it is a definite dollar amount. To allow it to be recovered repeatedly by baking it into the base rates would be unreasonable in the statutory sense. A surcharge mechanism would probably have to incorporate some assurance that all funds recovered through it would be counted as contribution, and not simply as undifferentiated revenue.

*Id.*

## 2. Postal Service Response

The Postal Service did not comment on the Public Representative's proposal that any exigent rate adjustment approved by the Commission be in the form of a surcharge that would be added to the prices approved in Docket No. R2013-10 and removed upon recoupment by the Postal Service of the amount found by the Commission to be due to the extraordinary or exceptional circumstance. It would appear that the Postal Service's decision not to comment on the Public Representative's proposal was due to the Postal Service's position, discussed above, that its requested exigent rate adjustment should be collected indefinitely.

## 3. Commission Analysis

For the reasons previously discussed, the Commission rejects the Postal Service's proposal to collect an exigent rate adjustment indefinitely. Instead, the Commission has developed a mechanism to enable the Postal Service to begin collecting an exigent rate surcharge effective January 26, 2014. That mechanism is explained below. Should the Postal Service prefer to use an alternative mechanism that does not over-recover the amount approved in this Order and otherwise complies with the findings in this Order, it may propose such a collection mechanism. Such proposal will be publicly noticed for comment and will be the subject of a further Commission order before it can be implemented. If the Postal Service chooses not to propose an alternative collection mechanism, it shall implement the collection mechanism discussed in the remaining portion of this Chapter.

The Postal Service has proposed a price increase of 4.3 percent, across the board, as detailed by witness Taufique. See Taufique Statement at 4-10. Witness Taufique describes how the Postal Service views the price increases of Docket No. R2013-10 and Docket No. R2013-11. Combined, these two price increases amount to a 6.0 percent price increase. *Id.*



Unlike the Postal Service's proposed ever-increasing estimate of financial harm, the Commission finds the financial harm to be a fixed amount. It is appropriate to recover that fixed amount through a surcharge rather than, as the Postal Service proposes, to include that amount into the base rates. This approach has two benefits. First, it permits tracking of the amount to be recovered to ensure not only that the Postal Service is fairly compensated but also that mailers are not overcharged. Second, it permits rates subject to the price cap to be administered independently.

The surcharge is calculated as the difference between the Docket No. R2013-11 prices and the Docket No. R2013-10 prices.<sup>151</sup> For example, the surcharge for First-Class Single-Piece letters is 2 cents, the difference between the Docket No. R2013-11 price of 49 cents and the Docket No. R2013-10 price of 47 cents.

As described in Chapter IV, the Commission identified the maximum total volume loss by class due to the Great Recession. That volume loss results in a quantifiable one-time contribution loss.

The Commission has determined, for the reasons stated in Chapters V and VI, *supra*, that the Postal Service's proposed exigent rate adjustment, designed to yield approximately \$1.8 billion in additional FY 2014 annual contribution, meets the "reasonable and equitable and necessary" requirements of section 3622(d)(1)(E). The Postal Service expects its exigent rates to recover \$1.8 billion in contribution annually, thus it will take longer than 12 months to recover the full \$2.8 billion in contribution authorized by the Commission. For this reason, the Commission must establish a mechanism for determining when the Postal Service will have recovered the full amount of the contribution loss, so that the exigent surcharge can be removed. Based on Postal Service projections, it appears that the time to recover the full amount of lost contribution will take longer than a year, but less than two.

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<sup>151</sup> The Postal Service measures the 4.3 percent price increase as the difference between the Docket No. R2013-11 prices and the Docket No. R2013-10 prices, not the percent increase from current prices established in Docket No. R2013-11. Taufique Statement at 4.

It is also possible that conditions could change in a way that might speed up or slow down recovery time for the full amount. The amount of time projected for the contribution recovery to occur requires that the collection be tracked, either monthly or quarterly.

Financial harm is expressed in lost contribution. However, recovery of lost contribution requires quantification of both revenues and attributable costs by product. The latter are not available on a monthly or quarterly basis because the Postal Service's underlying sampling systems are designed to produce annual cost estimates. There are not enough quarterly or monthly sample observations to produce statistically reliable product costs. Thus, tracking contribution from the exigent rates is not possible on a monthly or quarterly basis.

The Postal Service reports quarterly (and monthly) revenues and volumes. These reported figures are statistically reliable and can be used to reasonably track the amount of exigent surcharge revenue accruing to the Postal Service. In addition to being transparent, there are two additional benefits from using this tracking system. First, it does not depend on the accuracy of the Postal Service's forecast model because the surcharge revenue will be calculated using actual volumes, instead of projected volumes as used by the Postal Service. Second, even if contribution could be tracked reasonably accurately, there would be no incentive for the Postal Service to continue to reduce unit attributable costs if it is entitled to an aggregate amount of contribution. If unit attributable costs were to rise, the surcharge would have to stay in place longer to recover the allowable contribution. In contrast, tracking surcharge revenue should incentivize the Postal Service to reduce unit attributable costs because this would allow it to recover additional contribution. If the Postal Service is able to reduce attributable costs faster than it currently projects and gain additional contribution (and liquidity), mailers will not have to pay additional surcharges. Alternatively, if unit attributable costs increase, the Postal Service will accrue less contribution. Either

occurrence is limited by the surcharge revenue cap. Once the cap has been recovered, the exigent surcharge rates will be removed in the manner discussed below.

The Postal Service's updated workpapers detail that the projected contribution increase from the Docket No. R2013-11 surcharge is \$1.8 billion. The \$1.8 billion is converted into an annual revenue equivalent. The Postal Service estimates this figure using the Docket No. R2013-11 prices and a set of projected FY 2014 volumes and unit costs. As discussed above, the proposed prices are functionally a surcharge above the CPI-capped Docket No. R2013-10 prices. The amount of the surcharge, by subclass, is calculated by comparing the Docket No. R2013-10 prices and Docket No. R2013-11 prices. The additional revenue from the surcharge is projected to be \$2.1 billion, calculated using FY 2014 volumes projected by the Postal Service and the amount of the surcharge. Table VII-1 shows the derivation of the \$2.1 billion.

**Table VII-1**

**Projection of Additional Revenue in FY 2014 (After Rates) From Surcharge**

	<b>Projected FY 2014 After Rates Volumes (in Millions)</b>	<b>Average Per Piece Surcharge</b>	<b>Revenue From Surcharge</b>
<b>Total First-Class</b>	61,593	\$0.019	\$1,149,557,245
<b>Total Standard Mail</b>	80,130	\$0.009	\$750,544,452
<b>Total Periodicals</b>	6,097	\$0.011	\$69,692,050
<b>Total Package Services</b>	526	\$0.144	\$75,698,714
<b>Total Domestic Market Dominant Services</b>	2,724	\$0.027	\$72,996,619
<b>Total Market Dominant</b>	151,640	\$0.014	\$2,118,489,079

The Commission's estimate of the contribution loss due to the Great Recession in FY 2014 is \$2.8 billion. To determine the surcharge revenue limitation, the Commission must calculate the revenue required to achieve the target additional contribution of \$2.8 billion. Because the contribution amount is in addition to the contribution that would be generated absent the surcharge, the Commission compares the projected surcharge revenue to projected additional contribution for FY 2014. The Commission's target additional contribution is 1.53 times higher than the Postal

Service's projected contribution recovery in FY 2014. Therefore, the amount of revenue to be recovered is 1.53 times greater than the additional revenue the Postal Service estimated it would recover in FY 2014. Table VII-2 shows how the revenue surcharge limitation is calculated.

**Table VII-2**  
**Calculation of Revenue Surcharge Limitation**  
**(\$ in Millions)**

Line No.	Source	Description	Amount
1	PRC-LR-2013-1-1	Postal Service's Projected Contribution	\$ 1,809
2	Table IV-8	Commission's Projected Contribution Loss	\$ 2,766
3	Line 2 / Line 1	Ratio of Commission's Projected Contribution Loss to Postal Service's Projected Contribution Loss	1.53
4	Table VII-1	One Year Revenue from Exigent Rate Adjustment	\$ 2,118
5	Line 3	Ratio of Commission's Projected Contribution Loss to Postal Service's Projected Contribution Loss	1.53
6	Line 4 x Line 5	Revenue to be Recovered from Exigent Surcharge in Excess of Postal Service Annual Projection	\$ 3,238

The revenue surcharge limitation is \$3.2 billion. As detailed in the table, both the contribution and revenue recovery are projected to take the same amount of time, just over 18 months. If the Postal Service has accurately projected the volumes and cost by product, the revenue limitation will produce the precise amount of contribution determined by the Commission to be due to the extraordinary or exceptional

circumstances of the Great Recession. The revenue from the surcharge can be tracked on a regular basis to ensure that the implementation remains consistent with the statute.

Consistent with the intent of this Order, the Postal Service will report the incremental and cumulative surcharge revenue to the Commission 30 days after the end of each quarter.

a. Removal of the Surcharge

To ensure timely removal of the surcharge and thereby avoid over-collection of the approved exigent rate adjustment, the Postal Service is required to file a report with the Commission not later than May 1, 2014. That report shall include a proposed plan for removing the exigent rate surcharge with a complete explanation of how the plan will operate. Public notice of the Postal Service's filing shall be issued and interested persons shall be given an opportunity to comment. The Commission expects to issue a further order approving or modifying the plan. The Postal Service shall file a notice of removal of the surcharge not later than 45 days prior to the effective date of such removal.

## VIII. OTHER ISSUES

Commenters raise additional issues somewhat tangential to the Postal Service's exigent request and its compliance with 39 U.S.C. § 3622(d)(1)(E) and 39 C.F.R. § 3010.60 *et seq.* Those issues are discussed herein.

### A. Treatment of Unused Rate Adjustment Authority

#### 1. The Regulations

For inflation-based rate adjustments, a rate adjustment for a class of mail that is below the annual limitation results in unused rate adjustment authority for that class. 39 C.F.R. § 3010.4(c). Subject to certain exceptions, Commission regulations permit the Postal Service to apply the unused authority in subsequent rate adjustments. *Id.* However, if the Postal Service does not apply it, the unused authority lapses five years after the date of filing of the notice of rate adjustment that led to its calculation. 39 C.F.R. § 3010.26(e).

When the Postal Service seeks to make an exigent rate adjustment, it is required to "identify the unused rate adjustment authority available as of the date of the request for each class of mail and the available amount for each of the preceding 5 years." 39 C.F.R. § 3010.63(a).

The exigent provision in the statute includes a proviso, "provided there is not sufficient unused rate authority...." This clause imposes a condition on the bringing of an exigent request. 39 U.S.C. § 3622(d)(1)(E). In its regulations, the Commission implements the condition with the following rule: "Exigent increases will exhaust all unused rate adjustment authority for each class of mail before imposing additional rate adjustments in excess of the maximum rate adjustment for any class of mail. 39 C.F.R. § 3010.63(c). Pursuant to this rule, all unused authority for each class of mail is exhausted before the exigent rate adjustments are imposed.

The unused rate adjustment authority for four classes of mail – First-Class Mail, Standard Mail, Periodicals, and Package Services – is negative. The unused rate adjustment authority for the Special Services class is positive. In its Request, the Postal Service provides a table listing the unused authority for each class. Revised Request at 37. That table is reproduced below as table VIII-1.

**Table VIII-1**  
**Unused Rate Adjustment Authority**

<b>CLASS</b>	<b>UNUSED AUTHORITY</b>
First-Class Mail	- 0.463 %
Standard Mail	- 0.397 %
Periodicals	- 0.524 %
Package Services	- 0.312 %
Special Services	+ 1.814 %

## 2. Comments

The Postal Service, the Public Representative, and Valpak each discuss how unused authority should be treated in this exigent rate request.

*Postal Service.* The Postal Service offers two alternative approaches for treating unused authority. Its preferred approach is for the Commission to harmonize the exigent rate adjustment to reflect the state of affairs that would have been obtained if the Commission did not deny the First Exigent Request. Request at 36. Under its preferred approach, the unused rate authority that was available to the Postal Service when it filed its First Exigent Request in July 2010, would be exhausted, “while price adjustments resulting from inflation after that date...require[ ] no special accounting.” *Id.* The Postal Service concedes that some unused rate authority that was available to it in the First Exigent Request has subsequently expired. *Id.* However, it does not provide, as Commission regulations require, an update to the unused rate authority that was available to it when it filed the First Exigent Request. See First Exigent Request at 13.

The Postal Service contends that if the Commission adopts its preferred approach, 0.577 percent of the negative unused rate authority that it claimed in Docket No. R2011-2 would be exhausted because it represents deflation from a period that preceded its July 2010 exigent filing. Request at 36. The Postal Service acknowledges that it also claimed 1.161 percent of positive unused rate authority in Docket No. R2011-2 representing inflation from a period that preceded its July 2010 exigent filing. *Id.* at 37. The Postal Service contends that the disparate treatment of positive and negative pre-July 6, 2010 rate adjustment authority “should not trouble the Commission” because the amount of contribution it seeks in this Request (\$1.78 billion) is less than the amount it sought in the First Exigent Request (\$3.1 billion). *Id.*

Under its alternative approach, if the exigent request is approved, all unused rate authority currently available to the Postal Service – positive and negative – would be eliminated. *Id.* The Postal Service describes the treatment of Special Services’ unused authority as an “anomaly” insofar as “a significantly greater proportion of the exigent increase for Special Services would be attributable to implicit banked price authority than for any other class, simply because Special Services has benefited from prior price reductions.” *Id.* at 38.

*Public Representative.* The Public Representative contends that the Postal Service’s alternative approach, “which zeros out all currently unused pricing authority,” is the only approach that is consistent with the Commission regulations. PR Comments at 36. He contends that the purpose of the exhaustion rule is to “wipe the slate clean as a result of an exigent request.” *Id.* He asserts that this promotes predictability and stability in rates following approval of an exigent request. The Public Representative contends that the Postal Service’s preferred approach, by enabling it to exhaust pre-July 2010 negative rate authority, is “self-serving.” *Id.* at 37. He concludes that if the exigent rate request is approved, the unused rate adjustment authority for all classes should be reduced to zero. *Id.*



*Valpak.* Valpak criticizes the Postal Service for not addressing how negative unused rate authority will be treated if the exigent request is approved. It makes two arguments.

Valpak contends that under the Commission's exhaustion rule, "negative banked authority must be used first, and then the percentage price increases calculated from that level..." Valpak Comments at 80. Citing Nickerson, Valpak states that the Governors "firmly ruled" that the combined inflation-based and exigent rate requests could not exceed 6.0 percent. Valpak provides a table that combines unused rate authority – treating the negative unused authority as a rate increase and the positive unused authority as a rate decrease – with the rates requested in the exigent request and comes up with a figure that it denominates as "Increase Over Authority." *Id.* at 82. It then adds this figure to the rate increases that the Postal Service requested in the inflation-based request to come up with a "total" figure. Because the total, calculated in this way, exceeds six percent for the four classes of mail with negative unused rate authority, Valpak argues that the "price increases exceed the 6 percent maximum" approved by the Governors. *Id.*

In the alternative, Valpak asserts that because the effect of an exigent rate increase is to "absorb" all unused rate authority – positive and negative – when the exigent rates are rescinded, either (1) the rates should be "rolled back" to a new level below existing rates to account for the absorption of negative rate authority or (2) the unused rate authority must be restored. *Id.* at 81. Valpak warns that if the Commission does not account for the unused rate authority, it will fail to protect the price cap. *Id.* at 83.

### 3. Commission Analysis

The purpose of the exhaustion rule is to ensure that if the Postal Service has unused rate authority, it will apply its inflation-based and unused rate authority before

filing an exigent request. As the Public Representative notes, the rule also promotes predictability and stability in rates. PR Comments at 36.

Although the Postal Service purportedly filed the Request under Docket No. R2010-4R, the Commission reassigned the Request to a new docket, Docket No. R2013-11. The reasons for doing so are obvious. The Request differs substantially from the First Exigent Request in terms of the overall magnitude of the requested rate increases and the manner in which the requested rate increases are distributed across classes and products. In addition, much has changed in the three years since the Commission denied the First Exigent Request. Market dominant rates have been adjusted on five separate occasions. New market dominant products have been introduced, old market dominant products have been discontinued, and several former market dominant products have become competitive products. For these reasons, the Commission is treating the Request as a new request rather than an update of an old one. Thus for purposes of the exhaustion rule, the unused rate authority that must first be exhausted is the authority that was available when the instant Request was filed on September 26, 2013.

The Commission rejects Valpak's suggestion that Postal Service has, by exhausting its unused rate authority, constructively increased rates beyond the combined six percent threshold that the Governors approved.<sup>152</sup> Valpak's suggestion rests upon an interpretation of the exhaustion rule that requires that "negative banked authority must be used first, and then the percentage price increases calculated from that level." Valpak Comments at 80. But the rule itself states only that "[e]xigent increases will exhaust all unused rate adjustment authority...before imposing additional rate adjustments...." 39 C.F.R. § 3010.63(c). In applying this rule, the Commission construes the word "exhaust" in its ordinary sense, to mean "to consume entirely" or "to

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<sup>152</sup> The Governors must authorize rates, not merely the use of rate increase authority. 39 U.S.C. § 404(b).

draw off or let out completely.”<sup>153</sup> As applied to the Request, the exigent rate adjustment will exhaust all unused rate authority for each class, resulting in zero unused rate authority.

The regulations do not specifically address what impact exhaustion has on negative unused rate authority. Indeed, in establishing the rate adjustment regulations, the Commission declined to specify what impact exigent rate adjustments would have on unused rate adjustment authority. Order No. 43 at 72-73. The Commission recognizes that exhaustion of unused rate authority has a potential impact on the price cap. This issue, however, is not unique to the exigent regulations. The statutory requirement that unused rate authority lapse after five years time also has a potential impact on the price cap. 39 U.S.C. § 3622(d)(2)(C). The exigent regulations provide that the unused rate authority is exhausted. No additional regulation requires that rates be adjusted to account for the potential impact that exhaustion of unused rate authority might have on the price cap.

#### B. Contribution from Competitive Products

Nickerson states that because revenues for competitive products are “less than 20 percent of total revenues,” the recent price increase approved by the Commission<sup>154</sup> “does not materially impact [the Postal Service’s] liquidity or the analyses” in the Request. Nickerson Revised Statement at 20-21. UPS takes issue with the perceived notion that competitive products “cannot provide additional, much-needed relief to the Postal Service and Market-Dominant mailers.” UPS Comments at 2. UPS notes that the competitive products’ share of total revenue has risen from 11 percent in 2008 to 18 percent in 2012, while the required contribution from competitive products to cover institutional costs remains at 5.5 percent. *Id.* at 9. It contends that the only way to

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<sup>153</sup> Merriam-Webster’s Collegiate Dictionary, 10<sup>th</sup> ed. (2002) at 405.

<sup>154</sup> Docket No. CP2014-5, Order Approving Changes in Rates of General Applicability for Competitive Products, December 12, 2013 (Order No. 1903).

ensure that revenue from competitive products provides an additional contribution to institutional costs is for the Commission to increase the required contribution. *Id.* at 10. Although it acknowledges that the issues “before the Commission in this proceeding are relatively narrow,” UPS urges the Commission to “address the broader question of how best to allocate institutional costs so as to make up for contribution losses due to declining Market-Dominant volumes.” *Id.* at 12-13.

The Postal Service and the Parcel Shippers Association (PSA) contend that the Commission should not address the contribution that competitive products are required to make to institutional costs. The Postal Service notes that the Commission considered the issue last year and determined that the required contribution should remain at 5.5 percent.<sup>155</sup> Postal Service Reply Comments at 124. It asserts that commenters are free to petition the Commission for a re-evaluation of its determination in that docket provided they can show that circumstances have changed. The Postal Service contends that it has an interest in increasing revenue from competitive products and that market conditions (rather than the required contribution) provide it with the incentives it needs. PSA asserts that the current docket does not allow enough time for interested persons to consider and comment on, or for the Commission to consider, a proposal to adjust the required contribution of competitive products to institutional costs. PSA Reply Comments at 1-2.

The PAEA directs the Commission to promulgate a regulation to ensure that competitive products, collectively, bear an appropriate share of the Postal Service’s institutional costs and to review its appropriate share regulation every five years. 39 U.S.C. § 3633. The Commission reviewed its regulation last year and determined that the regulation should be retained in its current form. Order No. 1449 at 2. The present docket is not the appropriate forum to revisit the merits of that determination.

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<sup>155</sup> Docket No. RM2012-3, Order Reviewing Competitive Products’ Appropriate Share Contribution to Institutional Costs, August 23, 2012 (Order No. 1449).

## IX. ORDERING PARAGRAPHS

*It is ordered:*

1. The Commission finds that the Postal Service has justified the recovery of \$2.776 billion in additional contribution by showing an appropriate causal link between the extraordinary or exceptional circumstance of the Great Recession and mail volume losses.
2. The rates proposed by the Postal Service in Attachment A to its Request may go into effect on January 26, 2014 as a surcharge.
3. The Postal Service shall report incremental and cumulative surcharge revenue to the Commission 30 days after the end of each quarter.
4. The Postal Service shall file a report no later than May 1, 2014, providing a proposed plan for removing the surcharge from postage rates with a complete explanation of how the plan will operate.
5. The Postal Service may propose alternative collection mechanisms consistent with this Order.

Shoshana M. Grove  
Secretary

Commissioner Acton concurring.  
Vice Chairman Taub dissenting.

## SEPARATE VIEWS OF COMMISSIONER ACTON

In more than seven years' service as a Commissioner, this is the first instance that I have felt compelled to present separate views regarding a Commission decision. This speaks not only to the deliberative process of the panel and consensus building that occurs among Commissioners, but also to the significance of this decision and gravity of the Postal Service's current situation.

The Postal Service remains in a state of financial crisis. No one with knowledge of the facts and circumstances can deny that this crisis exists. Liquidity concerns and dire forecasts as to the Postal Service's financial condition arose before the Great Recession. It appears likely that financial uncertainty will continue its reign into the foreseeable future. Granting the Postal Service some or all of the pricing relief it seeks in this docket may help in the short term, but does not alter that reality. The Postal Service, regardless of the outcome of this exigent rate request, will face liquidity challenges in the near term.

The underlying driver in the present situation is that the Postal Service must be enabled to address structural challenges in its business model. Many of these concerns it will be unable to effectively resolve without legislative action. That does not mean, however, that the Postal Service may lawfully move to address unrelated structural concerns by way of a tool ill-suited to the task – the extraordinary or exceptional circumstances rate adjustment. As noted in this record: “[e]xpanding the exigency provision from a limited escape valve into an all-purpose vehicle for recovering losses of all kinds would leave captive mailers without any effective protection at all.”<sup>1</sup>

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<sup>1</sup> Reply Comments of MPA –The Association of Magazine Media, The American Catalog Mailers Association, Inc., Direct Marketing Association, Inc., Alliance of Nonprofit Mailers, National Newspaper Association, Quad/Graphics, Inc., RR Donnelley, Software & Information Industry Association/American Business Media, and Time Inc., December 6, 2013, at 8.

The Postal Accountability and Enhancement Act<sup>2</sup> (PAEA) ushered in a host of worthy changes. Central among them was the introduction of the price cap in place of a system that allowed postal rates to be set to recover the cost of service.<sup>3</sup> The advent of the price cap and PAEA reforms spurred Postal Service management to improve efficiencies by reducing costs and allowing flexibility to implement best business practices. Simultaneously the price cap provided the Postal Service's customers with more certainty as to the timing and amount of price increases.

While constructing a system whereby the Postal Service would be incentivized to behave more as a business and control its costs, the law also provided a safety valve, an emergency release to account for certain unusual occurrences. The Postal Service may, due to extraordinary or exceptional circumstances, request rates that pierce the inflation-based price cap. 39 U.S.C. 3622(d)(1)(E). The Commission must then determine if the proposed adjustment is "reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." *Id.*

In the system of ratemaking, the price cap is the rule, and the exigent rate provision the exception. This exception to the price cap is, and must therefore be, narrow. Order No. 547 at 67.

The Postal Service in this docket endeavors to use an exigent rate request, not as a precise and tailored instrument to make it whole for a discrete set of extraordinary or exceptional circumstances, but as a panacea to ameliorate underlying costs related to fundamental ongoing structural problems. I do not quibble that the Great Recession was an extraordinary or exceptional event. Likewise, I agree with all of my colleagues that the Postal Service was injured by the Great Recession. If I was a member of the Governors, and charged with approving management approaches within my control in

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<sup>2</sup> Pub. L. No. 109-435, 120 Stat. 3198 (2006).

<sup>3</sup> See Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustments, September 30, 2010, at 10 (Order No. 547).

an effort to move the Postal Service forward, I may well have voted for this exigent proposal, to request piercing of the price cap by over four percent into perpetuity as a prophylactic remedy. But I am not a Governor. As a Commissioner, I am charged with administering those provisions of title 39 within the Commission's purview. My responsibility is to uphold the law as it is written, not as some would like it to be.

One of the duties of a Commissioner is to review the Postal Service's request for an exigent rate adjustment for consistency with 39 U.S.C. 3622(d)(2)(E). With the aid of the Commission's resources and my professional experience, I am tasked with determining whether the Postal Service's requested exigent adjustment is "due to" the extraordinary or exceptional circumstances of the Great Recession. Further, I must determine if the proposed adjustment is reasonable, equitable, and necessary under the best practices of honest, efficient, and economical management to maintain and continue the development of postal services of the kind and quality adapted for the needs of the United States.

The Commission previously instructed the Postal Service to "quantify the net financial impact of the exigent circumstances."<sup>4</sup> That quantification is an upper-bound of what the Postal Service may request, and must "factor out the financial impact of non-exigent circumstances." *Id.* at 47-48. In this case, the Postal Service's analysis was not sufficient to "factor out the financial impact of non-exigent circumstances." With the body of evidence in the record before the Commission, I believe the amount calculated in this Order to be the most supportable quantification of the amount the Postal Service lost due to the discrete occurrence of the Great Recession using the data and methods available in this docket.

I recognize the Postal Service was adversely impacted by the extraordinary or exceptional circumstances of the Great Recession. I am aware too that it would in some sense be a convenient choice to allow the Postal Service to recover billions in

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<sup>4</sup> Docket No. R2010-4R, Order Resolving Issues on Remand, September 20, 2011, at 46 (Order No. 864).



additional revenues from mailers from now into eternity to offset a portion of the expense of existing structural constraints within the Postal Service's business model. The Postal Service proposes a perpetual recovery arrangement that may be revisited as part of the Commission's mandated 2017 review of the system of ratemaking.<sup>5</sup>

I believe, however, in following the law and limiting what the Postal Service may collect from mailers (who, it is key to note, have suffered also through the Great Recession) to those losses that are justifiably linked by supportable methods to the Great Recession. Further, I believe it is detrimental to the statutory objective of predictability and stability in rates, to tie ultimate resolution of an exigent recovery to a matter not yet before the Commission and unrelated to the discrete occurrence of the Great Recession. The Commission has a record before it, with input from the Postal Service, mailing stakeholders, and a representative of the general public, and it has a duty to resolve the issues presented in this docket within this docket.

There does indeed exist a so-called "new normal" that defines the business environment in the post-Great Recession world. The Postal Service's future, once it has been lawfully compensated for quantifiable losses due to the Great Recession, lies in its ability to adapt to this "new normal" environment as all sustainable businesses must.

The additional liquidity that the Postal Service so desperately needs cannot be endlessly extracted from mailers under the auspices of a narrow exception to the price cap. Rather, the postal model needs refinement that is beyond the scope of the price cap system (much less the narrow safety valve of the exigent provision). The Postal Service itself recognizes this need, and tacitly acknowledges that legislative reform may "obviate the need" for the exigent increase or mean that exigent rates are no longer

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<sup>5</sup> The Postal Service opines that it is hopeful that its proposed exigent rates will result in enough additional contribution to see it through 2017, referencing the Commission's review of the system of ratemaking under 39 U.S.C. 3622(d)(1)(E). See Renewed Exigent Request of the United States Postal Service, September 26, 2013, at 15 (Renewed Exigent Request).

“necessary” at some point in the future.<sup>6</sup> Many of the likely adjustments to the system are familiar and being debated: re-amortization of the retiree health benefit liability, change to the frequency or mode of delivery, workforce flexibility, independent management of health benefits, and others.

The determined and bipartisan work of our leaders in Congress makes postal reform a realistic goal. The Commission is a unique resource of postal experience and expertise, and stands ready to continue to support Congress, the Postal Service, and the mailing industry in bringing needed reforms.

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Commissioner Mark Acton

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<sup>6</sup> See Renewed Exigent Request at 6, 43; see *also* Reply Comments of the United States Postal Service, December 6, 2013, at 84.

## DISSENTING OPINION OF VICE CHAIRMAN TAUB

A. Overview.

The Commission's calculation of the contribution loss "due to" the Great Recession is contrary to Commission Order No. 864<sup>1</sup> (interpreting on Remand the relevant law (39 U.S.C. § 3622(d)(1)(E)) and regulations (39 C.F.R. § 3010.60-65)), and therefore, I must dissent. In brief, the Commission fails to reasonably measure both the volume loss due to the Great Recession and the continuing financial harm to the Postal Service caused by that volume loss. In addition, the Commission's methodology for rescinding the exigency increase has not been vetted with the public, and I am concerned about potential unintended consequences as a result.

B. The Commission fails to appropriately calculate the financial harm to the Postal Service "due to" the Great Recession.

In crafting the price cap regime, Congress built in a safety valve – the exigent provision – to address circumstances causing such substantial and unforeseen harm that the Postal Service could not adjust in the ordinary course of business. As acknowledged in the Commission's decision, the Postal Service suffered a catastrophic financial blow from the Great Recession (*i.e.*, the "extraordinary or exceptional circumstances"). Therefore, the task for the Postal Service is to quantify the net contribution loss due to the Great Recession.

In Order No. 864, the Commission explained that a precise revenue loss number was not required. While the Commission would not expect absolute precision, any number must be quantified with supportable methods and factor out the "non-exigent" circumstances. The Commission recognized that some exigent circumstances, such as a natural disaster that destroyed facilities, lend themselves to more accurate quantification than the very different evidentiary challenges presented by calculating the

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<sup>1</sup> Docket No. R2010-4R, Order Resolving Issues on Remand, September 20, 2011 (Order No. 864).

net adverse financial impact of the Great Recession and its impact on postal volumes. For a large exigent amount, as we have here, the Commission expected to see sophisticated data collection and estimation methodologies, as well as expert opinions and statistical analyses. The Commission assured the Postal Service that its concern that the causal nexus of “due to” would require a “strict level of precision,” “absolute precision,” or “perfect proportionality” was misplaced. “The Postal Service is not expected to engage in ‘a quixotic search for perfect proportionality....’ It is simply expected to support its exigent request with credible proof of the type described above.” Order No. 864 at 52.

The Postal Service complied with Order No. 864 by quantifying the net adverse financial impact of the Great Recession with a combination of econometric models and expert opinion. Based primarily on the work of its witness Thomas Thress, the Postal Service calculates those impacts in terms of estimated annual effects in a given year. Thress estimated, within each market dominant mail class, the volume loss by year attributable to the Great Recession.

Those losses do not include his separate estimates of mail volume by year and by class that was lost due to the continuing and on-going effects of pre-existing trends in electronic diversion. The Postal Service’s analysis calculates a material amount of additional electronic diversion. The Postal Service estimated that by Fiscal Year 2012, in addition to the billions of pieces of mail that were diverted to electronic media in 2007, an additional 12 billion pieces per year were being diverted, independent of the Great Recession.<sup>2</sup>

The Commission uses Thress’ model to estimate volume losses, but the Commission chooses to omit certain variables relied upon by Thress in this proceeding. The Commission also treats the Great Recession as a normal business cycle. It

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<sup>2</sup> The Postal Service in its witness testimony and answers to numerous Presiding Officer Information Requests (POIRs) (see, for example, POIR No. 3, question 1 and POIR No. 9, question 9), shows that 12 billion pieces is lost to diversion independent of the Great Recession and incorporates this into its net calculation of impact.

assumes that once the rate of volume decline for a class of mail is no longer increasing (or the rate of volume growth is no longer falling) on account of factors reflecting the Great Recession, the impact of the exigent circumstance – *i.e.*, the impact of the Great Recession – has ended. It considers any subsequent period as the “new normal” and that the Postal Service must simply adapt. Critically, the Commission fails to recognize the continuing financial harm associated with the volume loss.

Yet the objective established by Order No. 864 is that the Postal Service must estimate what mail volume would have been if the Great Recession had not occurred – in other words, *the volume lost due to the Great Recession*. Counter to what is required of the Postal Service, the Commission instead presumes that the effects of the Great Recession suddenly ended 3 years ago for most classes of mail.

1. Moving the goal posts: The Commission creates new standards and burdens of proof.

Order No. 864 outlined the nature and amount of proof as well as the supportable quantification methods required of the Postal Service. The Commission recognized that when faced with the unique circumstance of the Great Recession, statistical information and expert analysis would be part of the proof needed. In contrast, a straightforward exigency – for instance, destruction of facilities – would lend itself to more accurate calculations of equipment expenses and construction costs.

The Commission acknowledges in Order No. 864 that there would always be some degree of imprecision in the quantification of harm, particularly with regard to the difficulties inherent in untangling the interaction of multiple factors. It established a standard that the Postal Service must support its exigent request with credible proof based on a combination of econometric models and expert opinion. The Postal Service, through Thress and its entire postal demand analysis group, provides both, not only in Thress’ original Statement, but also in his responses to an extensive number of POIRs and his Reply.

However, the Commission now dismisses critical aspects of the Postal Service's data that are based on expert analysis and estimation methodologies. The Commission claims that Thress' conclusions regarding the relative roles of the Great Recession versus ongoing electronic diversion, and his choice of macroeconomic variables are "not justified." The Commission criticizes Thress for not including certain variables in his model, yet acknowledges that no commenter offered a model that included these variables and that the record is void of a model that is available to do so. The Commission appears to believe Thress should have developed one nonetheless. Separating volume lost due to the Great Recession from loss due to other factors, primarily electronic diversion, is, to say the least, challenging. While not without flaws, Thress' model and analysis represent a credible attempt to distinguish the causes of the volumes lost.

Moreover, as required by the U.S. Court of Appeals for the District of Columbia Circuit in remanding the original exigency case to the Commission, Order No. 864 specified the proof required for the Postal Service to demonstrate the causal nexus of "due to" – including guidance on quantification requirements, nature and amount of proof, supportable quantification methods, not exceeding the net adverse financial impact, and administrative feasibility. However, in Chapter IV, the Commission **now** introduces *four new standards* to determine the end of what can be calculated "due to" the exigent event, centered on a view of what is a purported "new normal."

Much should be expected of the Postal Service when requesting a rate change "due to" extraordinary or exceptional circumstances, but with no opportunity for input or comment, and contrary to Order No. 864, the Commission now requires a strict level of precision and imposes new additional standards.

2. The Postal Service is not a private company.

The Commission's adoption of a "new normal" is also problematic. The Commission assumes that there is no longer an exigent effect when certain macroeconomic factors indicate that volume decline has stabilized over a limited period

of time. In doing so, the Commission implies that the Postal Service can simply adjust to both volume level shifts and the change in the long-term trends as if it is a typical business cycle upturn.

But as the Postal Service has demonstrated, the Great Recession had a starkly atypical effect on mail volume.<sup>3</sup> The Great Recession appears to be much more similar in scope to the Great Depression. The Great Recession is neither “short term” nor a “cycle.” As demonstrated in POIR No. 1, question 9, among others, one impact of the Great Recession was to change long-run trends in mail volumes. This type of analysis is what is required by Order No. 864. The record before the Commission demonstrates that the Great Recession, and its impact on mail volumes, continues to have a negative impact on the Postal Service.

How is this “new normal” **not** “due to” to the exigent circumstance – the Great Recession? Under the Commission’s decision, the “new normal” suddenly ends the impact of the extraordinary and exceptional circumstance. 39 C.F.R. 3010.61(a)(7) requires an assessment of whether the exigent circumstances were foreseeable and could have been avoided by reasonable prior action. How could the continuing effects of the Great Recession on postal volumes been avoided by reasonable prior action? How is it that the Postal Service suddenly experiences no further impact from the Great Recession (*i.e.*, the extraordinary and exceptional circumstance) and that the continuing financial harm attributable to volumes lost due to the Great Recession has ended?

The Postal Service outlines in this case, and the Commission acknowledges, that the Postal Service has undertaken many efforts to adjust to the “new normal.” However, unlike entities in the private sector, the Postal Service cannot suddenly eliminate institutional costs in response to volume declines by shrinking the size and scale of its networks. As the Commission observes in Chapter V, the Postal Service is unlike a private company.

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<sup>3</sup> See, *e.g.*, Thress Reply at 9-11; Thress Statement at 7.

The Postal Service explains that its networks are much more a function of its universal service obligations and service standards rather than mail volume. It lacks the ability to react as quickly as private companies might in response to adverse circumstances. The “new normal” appears to assume the Postal Service could shed its fixed (institutional) cost obligations instantaneously with exogenous events. This view is unsupported on the record in this proceeding, yet the Commission uses it to truncate the financial harm caused by the Great Recession. Generally, the Postal Service must deliver mail to every address, and the size of the delivery network keeps growing every year despite the fact that mail volumes are declining. Universal service standards and obligations, rather than mail volume, are in many respects the more critical drivers of the scope of the required facility network.

By definition, the same is true of institutional costs. If specific cost components varied automatically in response to changes in mail volume, they would not be institutional costs, but rather volume-variable costs. With respect to volume-variable costs, the Postal Service has generally been able to adjust to the new lower overall levels of mail volume.<sup>4</sup>

However, the continued loss of contribution is due to the extraordinary and exceptional event of the Great Recession. Mail volume in 2011 and 2012 is substantially below what it would have been in the absence of the Great Recession, and therefore any evaluation of impact “due to” the effects of the Great Recession cannot ignore these “effects.” The continuing effect in these years is certainly not zero. In sum, the principal flaw in the Commission’s Order is the failure to recognize that, regardless of the volume loss found due to the Great Recession, the financial harm of that loss does not end immediately. While there may be disagreement over how long the recovery period should be, there can be no reasonable disagreement that it persists for some time.

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<sup>4</sup> Indeed, positive productivity is the *only* evidence that the Commission cites in the fourth prong of its newly created “due to” analysis in Chapter IV for the Postal Service purportedly adjusting to the “new normal.”



C. The formula to rescind the increase risks creating unintended consequences.

The Commission calculates the impact of the exigent event as a one-time loss of contribution. The Commission creates an approach that will measure the exigent recovery by revenue, not contribution. In doing so, it establishes a formula to rescind the exigent increase based on the level of “additional” revenue that will be estimated to result from the adjustment, calculated quarterly.

I am concerned that this formula is being imposed without the full benefit of broad public input and an opportunity to fully assess potential unintended consequences on both the Postal Service and mailers.

D. Concluding observations.

The Postal Service presents an extensive array of information demonstrating the effects of many shifts in consumer and business behavior triggered by the Great Recession. For example, as explained in POIR No. 1, question 9, the Great Recession continues to display more tenacity than almost anyone expected. Changes of this nature have a significant effect on underlying mail volume trends and continue to adversely impact the Postal Service.

Unlike every other recession since World War II, the Great Recession was accompanied by a financial crisis and a sustained drop in household net worth. The unemployment rate has exceeded seven percent for almost five years, despite the withdrawal of millions of discouraged workers from the labor force. Indeed, the unemployment rate would currently be 10.9 percent if the workforce participation rate were as high as it was in January 2009. Public attitudes have become deeply pessimistic in ways apparently unprecedented since World War II.<sup>5</sup> The economist and

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<sup>5</sup> In past recessions, more than half of Americans believed their incomes would grow in the next year; not this time. The share expecting gains collapsed to less than 45 percent after 2008 and is still below half, finds a study by Federal Reserve economist Claudia Sahm. See Federal Reserve “FEDS Notes” Sept. 26, 2013, *Why Have Americans' Income Expectations Declined So Sharply?* The despondency, she writes, may signal a permanent shift in consumer psychology that undermines recovery.

New York Times columnist Paul Krugman recently suggested that “depression-like conditions” might persist “for decades.”<sup>6</sup>

We are in unfamiliar economic territory and as demonstrated in this proceeding, effects “due to” the Great Recession persist. By law, regulation, and Order No. 864, the Postal Service must include in the “due to” calculation the *total* impact on mail volume from the exigent event (*i.e.*, the Great Recession). The Commission fails to account for the entire, ongoing impact of the exigent event on the Postal Service’s ability to recover lost contribution.

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Robert G. Taub, Vice Chairman

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<sup>6</sup> November 17, 2013, New York Times, Paul Krugman Op-Ed, *A Permanent Slump?*

**APPENDIX -A-**

**COMMENTS AND REPLY COMMENTS**

<b>COMMENTS</b>		
<b>PARTICIPANT</b>	<b>TITLE</b>	<b>FILING DATE</b>
American Bankers Association <b>(ABA Comments)</b>	Comments of American Bankers Association	November 26, 2013
Boardroom, Inc. <b>(Boardroom Comments)</b>	Comments of Boardroom, Inc.	November 27, 2013
Senator Susan M. Collins <b>(Senator Collins Comments)</b>	Letter, Re: Docket No. R2013-11, Rate Adjustment Due to Extraordinary Or Exceptional Circumstances	October 23, 2013
Financial Services Roundtable and National Association of Mutual Insurance Companies <b>(FSR &amp; NAMIC Comments)</b>	Comments in Opposition to USPS Renewed Request to Increase Postal Rates Due to Asserted Exigent Circumstances, Docket R2013-11	November 26, 2013
Greeting Card Association <b>(GCA Comments)</b>	Initial Comments of the Greeting Card Association	November 26, 2013
Clifton on behalf of the Greeting Card Association <b>(Clifton Statement)</b>	Statement of Dr. James A. Clifton on Behalf of the Greeting Card Association	December 3, 2013

COMMENTS		
PARTICIPANT	TITLE	FILING DATE
MPA – The Association of Magazine Media; Association for Postal Commerce; The American Catalog Mailers Association, Inc.; Direct Marketing Association, Inc.; Alliance of Nonprofit Mailers; Association of Marketing Service Providers; Major Mailers Association; National Newspaper Association; Printing Industries of America; Quad/Graphics, Inc.; R.R. Donnelley; Software & Information Industry Association/American Business Media; Time Inc. <b>(MPA et al. Comments)</b>	Initial Comments of MPA – The Association of Magazine Media, Association for Postal Commerce, the American Catalog Mailers Association, Inc., Direct Marketing Association, Inc., Alliance of Nonprofit Mailers, Association of Marketing Service Providers, Major Mailers Association, National Newspaper Association, Printing Industries of America, Quad/Graphics, Inc., R.R. Donnelley, Software & Information Industry Association/American Business Media, and Time Inc.	November 26, 2013
Lundblad on behalf of MPA et. al. <b>(Lundblad Statement)</b>	Statement of Christian T. Lundblad on behalf of MPA – The Association of Magazine Media, Association for Postal Commerce, the American Catalog Mailers Association, Inc., Direct Marketing Association, Inc., Alliance of Nonprofit Mailers, Association of Marketing Service Providers, Major Mailers Association, National Newspaper Association, Printing Industries of America, Quad/Graphics, Inc., R.R. Donnelley, Software & Information Industry Association/American Business Media, and Time Inc.	November 26, 2013
National Postal Mail Handlers Union <b>(NPMHU Comments)</b>	Comments of the National Postal Mail Handlers Union in Support of Postal Service Request for Rate Adjustment	November 27, 2013
The National Postal Policy Council; The Major Mailers Association; The National Association Presort Mailers; The Association for Mail Electronic Enhancement <b>(NPPC et al. Comments)</b>	Comments of the National Postal Policy Council, the Major Mailers Association, the National Association of Presort Mailers, and the Association for Mail Electronic Enhancement in Opposition to Exigent Rate Increase	November 26, 2013

<b>COMMENTS</b>		
<b>PARTICIPANT</b>	<b>TITLE</b>	<b>FILING DATE</b>
Buc on behalf of NPPC et al. <b>(Buc Statement)</b>	Statement of Lawrence G. Buc	November 26, 2013
The National Postal Policy Council; The Major Mailers Association; The National Association Presort Mailers; <b>(NPPC et al. Comments on Buc Statement)</b>	Comments of the National Postal Policy Council, the Major Mailers Association, and the National Association of Presort Mailers in Connection with the Attached Statement of Lawrence G. Buc	November 26, 2013
Pitney Bowes Inc. <b>(Pitney Bowes Comments)</b>	Comments of Pitney Bowes Inc.	November 26, 2013
Nickerson on behalf of the Postal Service <b>(Nickerson Statement)</b>	United States Postal Service Notice of Further Revisions to the Statement of Steven Nickerson—Errata	November 22, 2013
Taufique on behalf of the Postal Service <b>(Taufique Statement)</b>	Statement of Altaf Taufique on Behalf of the United States Postal Service	September 26, 2013
Taufique on behalf of the Postal Service <b>(Taufique Revised Statement)</b>	United States Postal Service Notice of Revisions to the Statement of Altaf Taufique—Errata	October 18, 2013
Taufique on behalf of the Postal Service <b>(Taufique Second Revised Statement)</b>	United States Postal Service Notice of Further Revisions to the Statement of Altaf Taufique—Errata	October 29, 2013
Thress on behalf of the Postal Service <b>(Thress Statement)</b>	Further Statement of Thomas E. Thress on Behalf of the United States Postal Service	September 26, 2013
Public Representative <b>(PR Comments)</b>	Public Representative Comments in Response to the Exigent Request of the United States Postal Service	November 26, 2013
Public Representative <b>(PR Revised Comments )</b>	Notice of Revisions to Public Representative Comments in Response to the Exigent Request of the United States Postal Service—Errata	December 2, 2013
Sacred Heart Southern Missions <b>(Sacred Heart Comments)</b>	Letter from Fr. Jack Kurps, SCJ, Executive Director, Sacred Heart Southern Missions	November 25, 2013

COMMENTS		
PARTICIPANT	TITLE	FILING DATE
Saturation Mailers Coalition; Small Business Legislative Council; Association of Free Community Papers; Independent Free Papers of America; Free Community Papers of Florida, Inc.; Midwest Free Community Papers Association; Wisconsin Community Papers; Texas Community Newspaper Association; Free Community Papers of New York; Mid-Atlantic Community Papers Association; Minnesota Free Papers Association; Community Papers of Michigan; Southeastern Advertising Publishers Association; Pacific Northwest Association of Want Ads Newspapers; Community Papers of New England <b>(SMC et al. Comments)</b>	Comments of the Saturation Mailers Coalition; Small Business Legislative Council; Association of Free Community Papers; Independent Free Papers of America; Free Community Papers of Florida, Inc.; Midwest Free Community Papers Association; Wisconsin Community Papers; Texas Community Newspaper Association; Free Community Papers of New York; Mid-Atlantic Community Papers Association; Minnesota Free Papers Association; Community Papers of Michigan; Southeastern Advertising Publishers Association; Pacific Northwest Association of Want Ads Newspapers; and Community Papers of New England	November 27, 2013
Software & Information Industry Association; American Business Media <b>(SIIA &amp; ABM Comments)</b>	Initial Comments	November 26, 2013
United Parcel Service <b>(UPS Comments)</b>	Initial Comments of United Parcel Service on Renewed Exigent Request of the United States Postal Service	November 26, 2013
Valassis Direct Mail, Inc. <b>(Valassis Comments)</b>	Initial Comments of Valassis Direct Mail, Inc.	November 26, 2013
Valpak Direct Marketing Systems, Inc.; Valpak Dealers' Association, Inc. <b>(Valpak Comments)</b>	Initial Comments of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc.	November 26, 2013
Valpak Direct Marketing Systems, Inc.; Valpak Dealers' Association, Inc. <b>(Valpak Revised Comments)</b>	Errata to Initial Comments of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc.	December 5, 2013

<b>REPLY COMMENTS</b>		
<b>PARTICIPANT</b>	<b>TITLE</b>	<b>FILING DATE</b>
American Bankers Association <b>(ABA Reply Comments)</b>	Reply Comments of American Bankers Association	December 6, 2013
Greeting Card Association <b>(GCA Reply Comments)</b>	Reply Comments of the Greeting Card Association	December 6, 2013
MPA – The Association of Magazine Media; The American Catalog Mailers Association, Inc.; Direct Marketing Association, Inc.; Alliance of Nonprofit Mailers; National Newspaper Association; Quad/Graphics, Inc.; RR Donnelley; Software & Information Industry Association/American Business Media; Time Inc. <b>(MPA et al. Reply Comments)</b>	Reply Comments of MPA – The Association of Magazine Media, the American Catalog Mailers Association, Inc., Direct Marketing Association, Inc., Alliance of Nonprofit Mailers, National Newspaper Association, Quad/Graphics, Inc., RR Donnelley, Software & Information Industry Association/American Business Media, and Time Inc.	December 6, 2013
National Postal Mail Handlers Union <b>(NPMHU Reply Comments)</b>	Reply Comments of the National Postal Mail Handlers Union in Support of Postal Service Request for Rate Adjustment	December 6, 2013
The National Postal Policy Council; The Major Mailers Association; The National Association of Presort Mailers; The Association for Mail Electronic Enhancement <b>(NPPC et al. Reply Comments)</b>	Reply Comments of the National Postal Policy Council, the Major Mailers Association, the National Association of Presort Mailers, and the Association for Mail Electronic Enhancement	December 6, 2013
Parcel Shippers Association <b>(PSA Reply Comments)</b>	Reply Comments of the Parcel Shippers Association	December 6, 2013
Postal Service <b>(Postal Service Reply Comments)</b>	Reply Comments of the United States Postal Service	December 6, 2013
Postal Service <b>(Postal Service Revised Reply Comments)</b>	Notice of Filing Errata to Reply Comments of the United States Postal Service (accompanied by “Reply Comments of the United States Postal Service”)	December 9, 2013

REPLY COMMENTS		
PARTICIPANT	TITLE	FILING DATE
Public Representative <b>(PR Reply Comments)</b>	Public Representative Reply Comments in Response to the Exigent Request of the United States Postal Service	December 6, 2013
Thress on behalf of the Postal Service <b>(Thress Reply Comments)</b>	Reply Statement of Thomas E. Thress on Behalf of the United States Postal Service	December 6, 2013
Time Inc. <b>(Time Inc. Reply Comments)</b>	Reply Comments of Time Inc.	December 6, 2013
Valpak Direct Marketing Systems, Inc.; Valpak Dealers' Association, Inc. <b>(Valpak Reply Comments)</b>	Reply Comments of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc.	December 6, 2013



**APPENDIX -B-****PRESIDING OFFICER INFORMATION REQUESTS AND RESPONSES**

<b>PRESIDING OFFICER INFORMATION REQUESTS</b>	
<b>TITLE</b>	<b>FILING DATE</b>
Presiding Officer's Information Request No. 1 <b>(POIR No. 1)</b>	October 23, 2013
Presiding Officer's Information Request No. 2 <b>(POIR No. 2)</b>	October 23, 2013
Presiding Officer's Information Request No. 3 <b>(POIR No. 3)</b>	October 25, 2013
Presiding Officer's Information Request No. 4 <b>(POIR No. 4)</b>	October 29, 2013
Presiding Officer's Information Request No. 5 <b>(POIR No. 5)</b>	October 29, 2013
Presiding Officer's Information Request No. 6 <b>(POIR No. 6)</b>	November 6, 2013
Presiding Officer's Information Request No. 7 <b>(POIR No. 7)</b>	November 8, 2013
Presiding Officer's Information Request No. 8 <b>(POIR No. 8)</b>	November 15, 2013
Presiding Officer's Information Request No. 9 <b>(POIR No. 9)</b>	November 21, 2013
Presiding Officer's Information Request No. 10 <b>(POIR No. 10)</b>	November 21, 2013
Presiding Officer's Information Request No. 11 <b>(POIR No. 11)</b>	November 21, 2013
Presiding Officer's Information Request No. 12 <b>(POIR No. 12)</b>	December 5, 2013

POSTAL SERVICE RESPONSES TO PRESIDING OFFICER INFORMATION REQUESTS	
TITLE	FILING DATE
Response of the United States Postal Service to Questions 1-9 of Presiding Officer's Information Request No. 1 <b>(Response to POIR No. 1)</b>	October 30, 2013
Response of the United States Postal Service to Questions 1-8 of Presiding Officer's Information Request No. 2 <b>(Response to POIR No. 2)</b>	October 30, 2013
Response of the United States Postal Service to Presiding Officer's Information Request No. 2, Question 9 <b>(Response to POIR No. 2, question 9)</b>	November 8, 2013
Response of the United States Postal Service to Questions 1-12 of Presiding Officer's Information Request No. 3 <b>(Response to POIR No. 3)</b>	November 1, 2013
Response of the United States Postal Service to Questions 1-10 of Presiding Officer's Information Request No. 4 <b>(Response to POIR No. 4)</b>	November 5, 2013
Response of the United States Postal Service to Questions 1-9 of Presiding Officer's Information Request No. 5 <b>(Response to POIR No. 5)</b>	November 5, 2013
Response of the United States Postal Service to Question 2.C of Presiding Officer's Information Request No. 6 <b>(Response to POIR No. 6, question 2.c.)</b>	November 6, 2013
Response of the United States Postal Service to Questions 1-27 of Presiding Officer's Information Request No. 6 <b>(Response to POIR No. 6)</b>	November 13, 2013
Supplemental Material for Response of the United States Postal Service to Question 15.C of Presiding Officer's Information Request No. 6 <b>(Response to POIR No. 6, question 15.c.)</b>	November 15, 2013
Notice of the United States Postal Service of Revised Attachment to Response to Question 14 of Presiding Officer's Information Request No. 6—Errata <b>(Revised Response to POIR No. 6, question 14)</b>	November 15, 2013
Notice of the United States Postal Service of Revisions to Response to Parts B and C of Question 2 of Presiding Officer's Information Request No. 6—Errata <b>(Revised Response to POIR No. 6, question 2.a. &amp; b.)</b>	November 18, 2013
Response of the United States Postal Service to Questions 1-2 of Presiding Officer's Information Request No. 7 <b>(Response to POIR No. 7, questions 1-2)</b>	November 12, 2013

POSTAL SERVICE RESPONSES TO PRESIDING OFFICER INFORMATION REQUESTS	
TITLE	FILING DATE
Response of the United States Postal Service to Questions 3-14 of Presiding Officer's Information Request No. 7 <b>(Response to POIR No. 7)</b>	November 15, 2013
Response of the United States Postal Service to Questions 1-7 of Presiding Officer's Information Request No. 8 <b>(Response to POIR No. 8)</b>	November 22, 2013
Response of the United States Postal Service to Question 6 of Presiding Officer's Information Request No. 8 <b>(Response to POIR No. 8, question 6)</b>	November 22, 2013
Response of the United States Postal Service to Questions 1-12 of Presiding Officer's Information Request No. 9 <b>(Response to POIR No. 9)</b>	November 29, 2013
Response of the United States Postal Service to Questions 1-7 of Presiding Officer's Information Request No. 10 <b>(Response to POIR No. 10)</b>	November 29, 2013
Response of the United States Postal Service to Questions 1-13 of Presiding Officer's Information Request No. 11 <b>(Response to POIR No. 11)</b>	November 29, 2013
Response of the United States Postal Service to Questions 1-2 of Presiding Officer's Information Request No. 12 <b>(Response to POIR No. 12)</b>	December 9, 2013